

2014

Legal and Economic Development with Sui Generis Chinese Characteristics: A Systems Theorist's Perspective

Dr. Xiao LI

Follow this and additional works at: <https://brooklynworks.brooklaw.edu/bjil>

Recommended Citation

Dr. Xiao LI, *Legal and Economic Development with Sui Generis Chinese Characteristics: A Systems Theorist's Perspective*, 39 Brook. J. Int'l L. (2014).

Available at: <https://brooklynworks.brooklaw.edu/bjil/vol39/iss1/3>

This Article is brought to you for free and open access by the Law Journals at BrooklynWorks. It has been accepted for inclusion in Brooklyn Journal of International Law by an authorized editor of BrooklynWorks.

**LEGAL AND ECONOMIC
DEVELOPMENT WITH SUI GENERIS
CHINESE CHARACTERISTICS: A
SYSTEMS THEORIST’S PERSPECTIVE**

*Dr. Xiao LI**

INTRODUCTION.....	160
I. THEORETICAL BACKGROUND	168
<i>A. The Systems Theory</i>	168
<i>B. The CAS Theory</i>	171
1. Complexity	171
2. Adaptability	174
<i>C. Institutional Compatibility</i>	178
II. THE SUI GENERIS CHINESE CHARACTERISTICS	181
<i>A. Confucianism</i>	182
<i>B. The Dominance of the CCP</i>	185
1. The Omnipresence of the CCP	185
2. The Nomenklatura System	190
3. Adaptation of the Party	192
<i>C. The Symbiosis of Strong Central Control and Gradual Deregulation</i>	195
III. IMPLICATIONS ON THE ADAPTATION OF THE LEGAL SYSTEM.....	199
<i>A. Adaptation of the Legal System</i>	199
1. Adaptation with the Dominant Political System	199
2. Adaptation on the Dual Track	207
3. Adaptation in Fast Transition	210
<i>B. The Relevance of Rule of Law</i>	215
IV. COMPATIBLE SYSTEMS TO ACHIEVE SUSTAINABLE GROWTH	217

<i>A. The Role of Law</i>	217
<i>B. The Supplementary Nomenclatura System</i>	219
<i>C. The Importance of the Strong Central Control</i>	223
<i>D. Dynamic Compatibility to Achieve Sustainable Growth</i>	226
CONCLUSION.....	228

INTRODUCTION

The astonishing and persisting economic growth without a sound rule of law scheme in China has long been observed as an intriguing but troublesome mismatch.¹ The myth can largely be attributed to the inapplicability in China of the deterministic causal relationship between economic development and the rule of law, a conviction generally held by scholars of law and economics.² The premise of such a line of reasoning is

*Assistant Professor, City University of Hong Kong. My special thanks go to the editors of the *Brooklyn Journal of International Law* for their insightful and professional edits. All errors are my own.

1. Apart from economists, quite a large number of legal scholars have devoted their research to this issue. Representative works include RANDALL PEERENBOOM, *CHINA'S LONG MARCH TOWARD RULE OF LAW* (2002); JUDICIAL INDEPENDENCE IN CHINA: LESSONS FOR GLOBAL RULE OF LAW PROMOTION 86 (Randal Peerenboom ed., 2010); RANDALL PEERENBOOM, *CHINA MODERNIZES: THREATS TO THE WEST OR MODEL FOR THE REST?* 34 (2007); Donald C. Clarke, *Legislating for a Market Economy in China*, in *CHINA'S LEGAL SYSTEM: NEW DEVELOPMENTS, NEW CHALLENGES* 13, 14 (Donald C. Clarke ed., 2008); ULRIC KILLION, *MODERN CHINESE RULES OF ORDER: PARADOX OF LAW AND ECONOMICS* 189 (2007); STANLEY LUBMAN, *BIRD IN A CAGE: LEGAL REFORM IN CHINA AFTER MAO* 102 (2002); Yongqin Wang, *Understanding Economic Development and Institutional Change: East Asian Development Model Reconsidered with Implications for China*, 16 *J. CHINESE POL. SCI.* 47, 48 (2011).

2. This understanding first starts from the differentiation between common law regimes and civil law regimes. According to the Legal Origin theory, common law regimes tend to have better performance in capital markets and economic development in general. For a brief but apt summary, see John Ohnesorge, *China's Economic Transition and the New Legal Origins Literature*, 14 *CHINA ECON. REV.* 485, 487 (2003). For legal origin theory, see Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46 *J. ECON. LITERATURE* 285, 298 (2008). According

the existence of a simplistic, linear causal relationship between a country's institutional framework and its observed economic performance.³ In essence, the separation of power among the legislature, the judiciary, and the executive administration sets up a sound framework in which the necessary, if not sufficient, conditions for healthy economic development are said to be in place.⁴ Economic development without such a framework is seemingly in conflict with this traditional wisdom.

Along with such a line of reasoning, development must occur through a dramatic shift, as happened when the Soviet Union and its former satellites abandoned communism, and replaced it with the democratic legal framework of the dominant Western

to La Porta et al., "legal origins—broadly interpreted as highly persistent systems of social control of economic life—have significant consequences for the legal and regulatory framework of the society, as well as for economic outcomes." *Id.* at 326.

3. For a critical review of the Legal Origin theory, see Ruth Aguilera & Cynthia Williams, "*Law and Finance*": *Inaccurate, Incomplete, and Important*, 6 *BYU L. REV.* 1413 (2009), and the three fallacies—"the extrapolation fallacy" (by extending a conclusion at micro-levels to complex systems), "the transmission problem" (the unclear consequential link between legal origin, company law, and stock markets), and "the exogeneity paradox" (the assumption that legal institution can be separated)—identified by Professor Katharina Pistor. See Katharina Pistor, *Rethinking the "Law and Finance" Paradigm*, 6 *BYU L. REV.* 1647, 1648–62 (2009).

4. This can largely be attributed to the then widely promoted Washington Consensus, which was coined by John Williamson and targeted reform policies for Latin America. Among the ten original themes, the final theme is "The legal system should provide secure property rights without excessive costs and make these available to the informal sector." As stated by Williamson: "Shortly after I had written my 1989 paper, I began to get interested in the transition from communism to a market economy that was then in its early stages. It soon became clear that institutional issues were, or at least should be, at the heart of the transition, and that one of the most critical actions was defining property rights." See John Williamson, Senior Fellow, Inst. for Int'l Econ., *The Washington Consensus as Policy Prescription for Development*, A Lecture in the Series "Practitioners of Development" 11 (Jan. 13, 2004). Criticism against the Washington Consensus has long been in existence. See David Rodrik, *Goodbye Washington Consensus, Hello Washington Confusion? A Review of the World Bank's Economic Growth in the 1990s: Learning from a Decade of Reform*, 44 *J. ECON. LIT.* 973, 973–74 (2006); Charles Gore, *The Rise and Fall of the Washington Consensus as a Paradigm for Developing Countries*, 28 *WORLD DEV.* 789 (2000).

economies.⁵ This process of transformation was conducted at a huge cost and the long-term implications are still too early to tell.⁶

In stark contrast to the aforementioned transformation, China follows an alternative “evolutionary” approach, which is “piecemeal, partial, incremental, [and] often experimental.”⁷ While the efficacy of the Chinese approach has been made manifest in Chinese economic development over the past thirty years, its incongruence with the generally accepted theory of law and economics scholars presents some interesting areas for analysis.

To understand this phenomenon, legal scholars have been approaching it from a combination of backgrounds in sociology, economics, and political science. Among those approaches, recent developments in Systems Theory,⁸ the Complexity Theo-

5. See David Lipton & Jeffrey Sachs, *Creating a Market Economy in Eastern Europe: The Case of Poland*, 1990 BROOKINGS PAPERS ON ECON. ACTIVITY 75, 75–77; David Lipton & Jeffrey Sachs, *Privatization in Eastern Europe: The Case of Poland*, 1990 BROOKINGS PAPERS ON ECON. ACTIVITY 293 (1990). Also, for a comment on shock therapy, see Peter Murrell, *What Is Therapy? What Did It Do in Poland and Russia, Post-Soviet Affairs*, 9 POST-SOVIET AFF. 111 (1993).

6. The bleak picture can be observed in Theodore Gerber & Michael Hout, *More Shock than Therapy: Market Transition, Employment, and Income in Russia, 1991–1995*, 104 AMER. J. SOC. 1, 3–6 (1998). But see generally Vladimir Popov, *Shock Therapy Versus Gradualism Reconsidered: Lessons from Transition Economies after 15 Years* 1 (Ctr. for Econ. & Fin. Res. at New Econ. Sch., Working Paper No. 68, 2006). The author first separated the transformation period into two stages: the transformational recession, and the recovery and the process of economic growth. Several factors contributed to the former recession, which include the distortions in industrial structure, trade patterns accumulated during the period of central planning, and the collapse of state institutions during transition period. As the ill-effects of the former factors gradually disappeared in the recovery stage, the positive effects of the ongoing liberalization on economic growth became apparent. Still, the author admonished that “*institutional capacity and reasonable macroeconomic policy*” are prerequisites for successful economic growth.

7. Justin Yinfu Lin, *Lessons of China's Transition from a Planned Economy to a Market Economy* (Leon Kozminski Acad. of Entrepreneurship & Mgmt. (WSPiZ) & Tiger Distinguished Lectures Series No. 16, Dec. 17, 2004), available at <http://www.tiger.edu.pl/publikacje/dist/lin.pdf>.

8. See NIKLAS LUHMANN, *A SOCIOLOGICAL THEORY OF LAW* (Martin Albrow ed., Elizabeth King & Martin Albrow trans., 1985); GUNTHER TEUBNER, *LAW AS*

ry,⁹ and the Complex Adaptive System (CAS) theory¹⁰ are of special relevance. The adaptation of the Systems Theory from biology to social science has long been credited to Niklas Luhmann, who developed two key concepts—operational closure and structural coupling—to understanding the autopoietic development of a social system.¹¹ For a systems theorist, a system is embedded within an environment composed of other systems.¹² Due to the internal operational closure and the struc-

AN AUTOPOIETIC SYSTEM 16 (Anne Bankowska & Ruther Adler Blackwell trans., 1993). Though the theory itself has been criticized as too abstract to be meaningful in practice, some legal scholars have been trying to apply it to specific sectors of law. *See, e.g.*, Simon Deakin, *Evolution for Our Time: A Theory of Legal Memetics* (ESRC Ctr. for Bus. Research, Univ. of Cambridge, Working Paper No. 242), available at <http://www.cbr.cam.ac.uk/pdf/WP242.pdf>; Simon Deakin & Fabio Carvalho, *Systems and Evolution in Corporate Governance* (Eur. Corp. Governance Inst. (ECGI)—Law, Working Paper No.150/2010, Apr. 2, 2010), available at <http://ssrn.com/abstract=1581746>.

9. SUNNY AUYANG, *FOUNDATIONS OF COMPLEX-SYSTEM THEORIES IN ECONOMICS, EVOLUTIONARY BIOLOGY, AND STATISTICAL PHYSICS* (1998); ROBERT NORTHROP, *INTRODUCTION TO COMPLEXITY AND COMPLEX SYSTEMS* (2011); CHAOS THEORY IN THE SOCIAL SCIENCES FOUNDATIONS AND APPLICATIONS (Douglas Kiel & Euel Elliot eds., 1996).

10. JOHN H. MILLER & SCOTT E. PAGE, *COMPLEX ADAPTIVE SYSTEMS: AN INTRODUCTION TO COMPUTATIONAL MODELS OF SOCIAL LIFE* (2007); YIN SHAN & ANG YANG, *APPLICATIONS OF COMPLEX ADAPTIVE SYSTEMS* (2008). The general thesis is that social systems can be deemed CASs.

11. See the following discussion in Part I.

12. According to Luhmann, society as a system is subdivided into subsystems by a principle of functional differentiation:

One can describe a society as functionally differentiated as soon as it develops its main subsystems with a view towards specific problems which then will have to be resolved within the frame of every corresponding functional system. This implies to renounce to a fixed hierarchy among functions . . . Instead of such a hierarchy . . . one should establish the rule according to which every system takes its own function to take precedence over others and then conceives of others functional systems—and in fact of society as a whole—as its environment.

Julien Broquet, *Taking Full Advantage of Niklas Luhmann's Conceptual Apparatus? Governance at the Stake of a Three-way Differentiation* 3 (Int'l Univ. Ctr. [IUC], Conference: Applied System Theory: Niklas Luhmann's Theory of Self-Referential Systems: Theoretical and Empirical Research, Dubrovnik,

tural coupling with the external environment, a system must be studied within a network of systems.¹³ An inference can accordingly be drawn that co-evolution of a system and its environment is an inherent feature of the Systems Theory.

Alternatively, the Complexity Theory and the CAS theory supplement our understanding of the autopoiesis of systems by exploring the complexity of the co-evolution process. For Holland, CASs are “systems that involve many components that adapt or learn as they interact.”¹⁴ In a similar vein, Ruhl deems a CAS something “comprised of a macroscopic, heterogeneous set of autonomous agents interacting and adapting in response to one another and to external environment inputs.”¹⁵ It thus follows that social systems, including the legal system, the

Croatia, Sept. 14–18, 2009), available at <http://www.u-picardie.fr/~LaboERSI/travaux/fichiers/T595.pdf> (quoting and translating from NIKLAS LUHMANN, POLITIQUE ET COMPLEXITÉ 43–44 (1990), translated from SOZIOLOGISCHE AUFKLÄRUNG 4: BEITRÄGE ZUR FUNKTIONALEN DIFFERENZIERUNG DER GESELLSCHAFT (1987)). For Seidl, “[f]unctional systems constitute environment for each other.” This is because each system has its own language of a set of binary code and reproduces by self-reference. And “[t]he different systems are merely structurally coupled to each other, i.e. their structures are adjusted to each other in such a way as to allow them to react to their respective operations.” See David Seidl, *Luhmann’s Theory of Autopoietic Social Systems* 14 (Ludwig-Maximilians-Universität München Munich Sch. of Mgmt., Working Paper No. 2004-2, 2004). For the purpose of this article, the political system, legal system, and economic system are subsystems of the social system. Each of the three constitutes the part of the environment of some other subsystem of the social system. To facilitate discussion in this article, we assume that the social system constitutes the political system, the legal system, and the economic system only.

13. See generally Seidl, *supra* note 12.

14. John H. Holland, *Studying Complex Adaptive Systems*, 19 J. SYS. SCI. & COMPLEXITY 1, 1 (2006).

15. J.B. Ruhl, *Law’s Complexity: A Primer*, 24 GA. ST. U. L. REV. 885, 887 (2008). For Rihani, Complex Adaptive Systems share the following traits: “They have active internal elements that furnish sufficient local variety to enable the system to survive as it adapts to unforeseen circumstances. The systems’ elements are lightly but not sparsely connected. The elements interact locally according to simple rules to provide the energy needed to maintain stable global patterns, as opposed to rigid order or chaos. Variations in prevailing conditions result in many minor changes and a few large mutations, but it is not possible to predict the outcome in advance.” See SAMIR RIHANI, COMPLEX SYSTEMS THEORY AND DEVELOPMENT PRACTICE UNDERSTANDING NON-LINEAR REALITIES, 80 (2002).

economic system, and the political system can be termed as CASs.¹⁶ According to these theories, the co-evolution process places CASs almost always at the edge of chaos, though emergence of order may spontaneously occur.¹⁷ However, internal attractors and attractor basins capture the chaos, indicating

16. For the economic system as a CAS, see Herbert Gintis, *The Economy as a Complex Adaptive System* (2006) (reviewing ERIC D. BEINHOCKER, *THE ORIGIN OF WEALTH: EVOLUTION, COMPLEXITY, AND THE RADICAL REMAKING OF ECONOMICS* (2006)), available at <http://www.umass.edu/preferen/Class%20Material/Readings%20in%20Market%20Dynamics/Complexity%20Economics.pdf>; COMPLEX SYSTEMS IN FINANCE AND ECONOMETRICS (Robert A. Myers ed., 2010); John Foster, *Economic System*, in *PHILOSOPHY OF COMPLEX SYSTEMS*, 10 *HANDBOOK OF THE PHILOSOPHY OF SCIENCE* 508, 509–30 (Cliff Hooker et. al. eds., 2011), available at http://www.arabphilosophers.com/English/news/books/Philosophy_of_Complex_Systems.pdf. But for an opposing view, see John Foster, *Why Is Economics Not a Complex Systems Science?* (Univ. of Queensland Sch. of Econ., Discussion Paper No. 336, 2004) (Austl.). For the political system as CAS, see Bennett Stark, *A Case Study of Complex Adaptive Systems Theory: Sustainable Global Governance: The Singular Challenge of the Twenty-First Century* (Univ. of Ljubljana, RISC-Research Paper No. 5, July 2009) (Slovn.); Ken Kollman, John H. Miller & Scott E. Page, *Political Parties and Electoral Landscapes*, 1 *BRIT. J. POL. SCI.* 139 (1998); Gary Marks, *Rational Sources of Chaos in Democratic Transition*, 35 *AM. BEHAV. SCI.* 397 (1992); Kiel & Elliott, *supra* note 9, pt. 2; Jenna Bednar, *The Political Science of Federalism*, 7 *ANN. REV. L. & SOC. SCI.* 269 (2011). For the legal system as CAS, see J.B. Ruhl, *Complex Adaptive Systems Literature*, *VANDERBILT UNIV. SOC'Y FOR EVOLUTIONARY ANALYSIS IN LAW*, available at <https://www4.vanderbilt.edu/seal/scholarly-resources/complex-adaptive-systems-literature>; John Mixon & Kathleen McGlynn, *A New Zoning and Planning Metaphor: Chaos and Complexity Theory*, 42 *HOUS. L. REV.* 1221 (2006); Doni Gewirtzman, *Lower Court Constitutionalism: Circuit Court Discretion in a Complex Adaptive System*, 61 *AM. U. L. REV.* 457, 457–58, 506, 521–22 (2012); Gregory Todd Jones, *Dynamical Jurisprudence: Law as a Complex System*, 24 *GA. ST. U. L. REV.* 873, 882–83 (2008).

17. The chaos however is only the appearance. Chaos may “exist at detailed levels” but an order may emerge at the global level. RIHANI, *supra* note 15, at 7. As the chaos increases, emergence of qualities unforeseen at the level of individual elements of the system come into existence. In fact, some orderly qualities may be observed, as occurs with swarms of fireflies that will flash at the same time and same frequency. On this, Strogatz observes: “For reasons we don’t yet understand, the tendency to synchronize is one [of] the most pervasive drives in the universe, extending from atoms to animals, from people to planets.” See STEVEN STROGATZ, *SYNC: THE EMERGING SCIENCE OF SPONTANEOUS ORDER* 14 (2003).

that a system is capable of stabilizing itself.¹⁸ Such dynamic equilibriums of CASs are the result of continuing feedback or learning processes between agents within a system, and between a system and its environment.¹⁹ In turn, the sustainable

18. The development path of complex systems is captured by attractors, “the closed set of states a system repeatedly traverses when at equilibrium.” See Cliff Hooker, *Introduction to Philosophy of Complex Systems*, in PHILOSOPHY OF COMPLEX SYSTEMS, *supra* note 16, at 3, 24. Three types of attractors have been identified: (1) point attractors—equilibrium points where the system will tend to and then stop; (2) cyclical attractors—as what the pendulum does between two points; and (3) strange chaotic attractors in non-linear complex systems—the development path always distinct from the past path, an unpredictable evolutionary process that is decided by initial conditions. The strange chaotic attractors are thus relevant to the current study. For organized complex systems, there are a large number of attractors, which are similar but not identical. RIHANI, *supra* note 15, at 8, 78–80. However, the difference between attractors is within specific limits.

In general, a disturbance to a system at equilibrium will lead the system into one of three situations: (1) stay put within the current attractor basin; (2) be pushed to another attractor basin but of the same fitness landscape; or (3) transform to another attractor basin of a new fitness landscape. Though internal variations happen all the time, the system remains stable in the sense that it does not escape the attraction of existing attractors of the existing fitness landscape, or the picture of the whole system cannot easily change into another global pattern attracted by another set of attractors. If the latter happens, the structure of the system changes. Thus, it is the existence of these attractors that explains the emergence of order in seemingly chaotic systems. See Hooker, *supra*, at 23–25.

But notice that compared with the point attractor or cyclical attractors, the strange chaotic attractors provide more flexibility and resilience to the system. See J.B. Ruhl, *The Fitness of Law: Using Complexity Theory to Describe the Evolution of Law and Society and Its Practical Meaning for Democracy*, 49 VAND. L. REV. 1407, 1440–42 (1996); GRAHAM ROOM, COMPLEXITY, INSTITUTIONS AND PUBLIC POLICY, AGILE DECISION-MAKING IN A TURBULENT WORLD 129–36 (2011); Jamie Murray, *Complexity Theory & Socio-legal Studies*, 29 LIVERPOOL L. REV. 227 (2008).

Still, it must be mentioned that some minor variation may initiate a catastrophe through which the current equilibrium state of the system will shift into a totally different state with a new set of attractors. The intriguing issue is we cannot know beforehand which variation at what time will lead to the catastrophe. Accordingly, catastrophes are generally not welcomed in our discussion.

19. In Luhmann’s words, this is a recursive reference process, including both the internal self-reference and the external structural coupling between the system and its environment. Specifically, “[c]ommunication comes about

growth of a system is decided not only by the quality of the system on its own but also, more importantly, by the compatibility of the system with those other systems that make up its environment. The importance of such an understanding is at least twofold. First, the co-evolution between and among systems seriously constrains the application of the traditional wisdom that operates under the presumption that there *is* a simplistic, linear one-way causal relationship to be identified. Second, the role of a regulator in CASs is better deemed an adaptive manager who is good at understanding and responding to the dynamic and continuing learning process of the elements within systems.²⁰

The application of such theories to China demands an understanding of the sui generis Chinese characteristics: Confucianism, Chinese Communist Party (“CCP” or the “Party”) control, and strong, centralized government control, which reveal a distinctive configuration of the autopoiesis of Chinese systems. In contrast to the rather strong operational closure of the legal system in Western countries, the Chinese legal system has a relatively weak internal operational closure and a strong, but nearly one-way, structural coupling in which it is subjugated to both the economic system (at least during the fast growth period) and the political system.²¹ With such a configuration of autopoiesis, the Chinese legal system has been adapting on dual track schemes and via experiments, yielding meaningful experiences that can be put to use on a wider scope. Additionally, the adaptive efficiency of China’s system requires strong compatibility among different systems. Indeed, both the dominant CCP control and strong central government control have largely been employed to support economic growth. Specifically, deregula-

by splitting reality through a highly artificial distinction between utterance and information, both taken as contingent events within an ongoing process that recursively uses the results of previous steps and anticipates future ones.” See Niklas Luhmann, *Operational Closure and Structural Coupling: The Differentiation of the Legal System*, 13 CARDOZO L. REV. 1419, 1424 (1992).

20. Even though Ruhl is describing the recent development in American court management, the quotation is applicable to the trial-and-error style adaptive walk. See J.B. Ruhl & Robert L. Fischman, *Adaptive Management in the Courts*, 95 MINN. L. REV. 424, 428 (2010).

21. See *infra* Part II.

tion to local governments, which provides opportunities to apply trial-and-error techniques, is put to effective use by strong central and CCP control in coupling or learning between patches of the system.²² Effective and efficient learning processes may accordingly have been achieved for the whole system. Retrospectively, the government has largely realized its role as an adaptive manager of CASs.

The structure of the Article is as follows. Part I will give a brief introduction to the systems theories. Next, Part II will describe sui generis Chinese Characteristics. This background information will then be used to apply the Systems Theory to the adaptation of Chinese legal systems in Part III, and show in Part IV how the compatibility among different systems has contributed to persistent economic growth in China over the past thirty years.

I. THEORETICAL BACKGROUND

A. *The Systems Theory*

By adapting the autopoiesis of organizations in biology, Niklas Luhmann develops the Systems Theory for social science.²³ For biologists, autopoiesis implicates both self-reference and self-reproduction of elements of biological organizations.²⁴ Self-reference refers to a development process relying on the interactions among and between internal constituent elements of an organization; self-reproduction is a concomitant result of

22. "Patch" has a special meaning in Complexity Theory. The idea is attributed to Stuart Kauffman, who created this concept in his book. STUART KAUFFMAN, *AT HOME IN THE UNIVERSE* 252–57 (2000). Patches are decision-making units of a complex adaptive system, which do not overlap but are coupled with each other. In China, the provinces can appropriately be deemed patches, which is similar to the well-known models of "competitive federalism." For an application of the patching theory to decision making, see David Post & David Johnson, "*Chaos Prevailing on Every Continent*": *Towards a New Theory of Decentralized Decision-Making in Complex Systems*, 73 CHI.-KENT L. REV. 1055 (1998).

23. See *supra* note 5.

24. HUMBERTO R. MATURANA & FRANCISCO J. VARELA, *Introduction*, in *AUTOPOIESIS AND COGNITION: THE REALIZATION OF THE LIVING*, available at http://topologicalmedialab.net/xinwei/classes/readings/Maturana/autopoiesis_and_cognition.pdf.

this self-referential process.²⁵ Viewed from this feature alone, organizations are autopoietic in that they are operationally closed.

In social science, Luhmann defines a system through the process of delineating a system from its environment, which is comprised of a number of other systems.²⁶ Within a system, a program using a language of a binary code dictates the operation of the elements of the system.²⁷ Interactions between a system and its external environment are achieved by structural coupling, meaning the communication of information or learning in social science.²⁸ Given that a system is embedded within its environment, structural coupling provides important information conduits between a system and its environment.

It shall be noted that both internal and external pressures may initiate a coupling process.²⁹ For instance, abrupt envi-

25. For Luhmann, “[s]ocial systems can only reproduce themselves by (always self-referential) communication.” See Niklas Luhmann, *The Unity of the Legal System*, in *AUTOPOIETIC LAW: A NEW APPROACH TO LAW AND SOCIETY* 16 (Gunther Teubner ed., 1987). Also, for Luksha, “By all means, self-reproduction *must* be self-referential, because it (a) requires system to operate on itself, (b) requires a system to maintain a representation (or some kind of description) of itself.” Pavel Luksha, *Society as a Self-Reproducing System*, 2 J. SOCIOCYBERNETICS 13, 15 (2001).

26. See the translation by Julien Broquet, *supra* note 12. The delineation of a social system and its environment hinges upon the operational closure of the system in which the binary code is employed. Accordingly, a social system cannot communicate with its environment but can only be structurally adjusted through structural coupling with the other subsystems in the environment.

27. The binary code can be understood in positive and negative terms. For instance, in law the binary code is legal or illegal; in politics, power or not in power; and in economics, possession or non-possession, or payment or non-payment.

28. Luhmann differentiates a social system from the other living systems by emphasizing communication, which is a synthesis of selection of information, and utterance. See NIKLAS LUHMANN, *SOCIAL SYSTEMS* 142 (Timothy Lenoir & Hans Ulrich Gumbrecht eds., John Bednarz, Jr. & Dirk Baecker trans., 1995). In essence, “the autopoiesis of social systems, i.e. the reproduction of communications through communications.” Seidl, *supra* note 12, at 9. See also Gunther Teubner, *The Two Faces of Janus: Rethinking Legal Pluralism*, 13 *CARDOZO L. REV.* 1443 (1992).

29. HUMBERTO R. MATURANA & FRANCISCO J. VARELA, *THE TREE OF KNOWLEDGE: THE BIOLOGICAL ROOTS OF HUMAN UNDERSTANDING* 74

ronmental changes may demand changes within a system,³⁰ or the intensive conflicts within a system may change the environment within which the system is embedded.³¹ Hence, a system both influences and is influenced by its environment. What is emphasized by systems theorists, however, is that external information must be digested by the internal elements to achieve autonomous self-reproduction.³² Thus, even though systems theorists juxtapose structural coupling with operational closure, the former serves the latter and the importance of structural coupling may easily be downplayed.

The Systems Theory approach departs from the focus of the traditional wisdom on the simplistic, linear causal relationship to a network study by considering any given system merely as a part of some greater network. Also, taking into account coevolution requires a continuing reflexive regulatory approach, according to which the regulator must be proactively responsive to the information communicated in the co-evolution process. In other words, too much inflexibility will lead to a rigid regulatory framework that is unsuitable to the dynamic co-evolution process.

(Shambhala Publications, Inc. rev. ed. 1987), available at [https://umdrive.memphis.edu/blatti/public/PHIL%207-8051%20-%20Ontology%20of%20Life%20-18.1%20S13/Readings/7-Mar%2018%20-%20Maturana%20and%20Varela%20-%20Tree%20of%20Knowledge%20-%20pt%20\(2\).pdf](https://umdrive.memphis.edu/blatti/public/PHIL%207-8051%20-%20Ontology%20of%20Life%20-18.1%20S13/Readings/7-Mar%2018%20-%20Maturana%20and%20Varela%20-%20Tree%20of%20Knowledge%20-%20pt%20(2).pdf).

30. Structural changes of antennae and wings of some butterflies were found recently by Japanese scientists after the collapse of the nuclear power stations in Fukushima. See Nick Crumpton, "Severe Abnormalities" Found in Fukushima Butterflies, BBC NEWS (Aug. 13, 2012), available at <http://www.bbc.co.uk/news/science-environment-19245818>.

31. For instance, how decision making in one nation leads to changes to the world system, as shown by the ramifications of the case of *William Marbury v. James Madison*, 5 U.S. 137 (1803), in the US.

32. In contrast with the biological reproduction of individuals, Luhmann argues that a social system reproduces itself by self-reference, but emphasizes the role of communication: "Social systems use communication as their particular mode of autopoietic reproduction. Their elements are communications which are recursively produced and reproduced by a network of communications and which cannot exist outside such a network." Niklas Luhmann, *The Autpoiesis of Social Systems*, in SOCIOCYBERNETIC PARADOXES OBSERVATION, CONTROL AND EVOLUTION OF SELF-STEERING SYSTEMS 172, 174 (Felix Geyer & Johannes van der Zouwen eds., 1986).

B. The CAS Theory

1. Complexity

While the Systems Theory identifies two key qualities of a social system—operational closure within the system and structural coupling between the system and the other systems in the environment—the recent development of the CAS Theory helps us better understand the complexity of the co-evolution between a system and its environment.³³ The study on the complexity of a system starts from the observation of chaos at the detailed levels of a system.³⁴ For activities of systems at detailed levels, simple deterministic biology, physics, and chemistry rules play their due roles.³⁵ However, once such rules repeat numerous times, tiny differences in the initial situation

33. Note that Professor Eve Mitleton-Kelly termed social systems as Complex Evolutionary Systems. See Eve Mitleton-Kelly, *Ten Principles of Complexity and Enabling Infrastructures*, in COMPLEX SYSTEMS AND EVOLUTIONARY PERSPECTIVES ON ORGANIZATIONS: THE APPLICATION OF COMPLEXITY THEORY TO ORGANIZATIONS (Eve Mitleton-Kelly ed., 2003). Mitleton-Kelly argues that:

Although we make a conceptual distinction between a ‘system’ and its ‘environment’ it is important to note that there is no dichotomy or hard boundary between the two . . . in the sense that a system is separate from and always *adapts* to a changing environment. The notion to be explored is rather that of a system *closely linked with* all other related systems within an ecosystem . . . Within such a context change needs to be seen in terms of *co-evolution with* all other related systems, rather than as *adaptation to* a separate and distinct environment.

Id. at 29–30.

Still, it must be noted that complex theory itself is full of complexity. Despite the exponential development for the past thirty years or so, Hooker observes that “there is no unified science of complex systems . . . the empirical domain of complex systems is itself complex—at this time irreducibly complex!” Hooker, *supra* note 18, at 3–90, 5.

34. Edward Lorenz, *Deterministic Nonperiodic Flow*, 20 J. ATMOSPHERIC SCI. 130 (1963). The modern Chaos theory originates from Edward Lorenz’s famous article. Professor Lorenz noticed that a particular meteorological model is sensitive to minor differences in the initial situation. For a brief introduction to the development of the Chaos theory, see Robert Bishop, *Chaos*, in THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY, *available at* <http://plato.stanford.edu/entries/chaos/#BriHisCha>.

35. See Robert Bishop, *supra* note 34.

will be amplified and lead to huge differences in the end results.³⁶ Likewise, a minute disturbance to the normal development process may also lead to unexpected results.³⁷ The randomness of the end results is called chaos, which is sensitive to the initial conditions of a system.³⁸

The above line of reasoning may also be applied to social science studies, as evidenced by the ability of human beings to learn from the past in planning for the future. Indeed, the autopoiesis of a social system is achieved through such a continuous ongoing information communication process, in which agents “recursively use the results of previous steps and anticipate future ones.”³⁹ As amplification of tiny differences of the initial states during the development process is normal, the application of the traditional linear thinking in social science may accordingly be constrained.

However, chaos does not provide the whole picture of the co-evolution of a system and its environment. Complexity theorists also note that the emergence of qualities unforeseen at the level of individual elements of a system come into existence as the chaos develops.⁴⁰ The unanticipated quality may well appear in an orderly way, or, to use the language of complexity theorists, an order may emerge at the global level despite chaotic localities.⁴¹ For instance, synchronization has been widely observed in both nature and in human society.⁴² Alternatively,

36. This is not to say that the difference cannot be suppressed, for amplification can be either positive or negative. See Hooker, *supra* note 18, at 24.

37. See RIHANI, *supra* note 15, at 80.

38. *Id.*

39. Niklas Luhmann, *Operational Closure and Structural Coupling: The Differentiation of the Legal System*, 13 CARDOZO L. REV. 1419, 1424 (1992).

40. RIHANI, *supra* note 15, at 7. For a brief history of emergence and its implication on social science studies, see Peter A. Corning, *The Re-emergence of Emergence, and the Causal Role of Synergy in Emergent Evolution*, 185 SYNTHESIS 295 (2012).

41. RIHANI, *supra* note 15, at 7.

42. See text accompanying note 17 *supra*. For example, some orderly quality has already been observed in swarms of fireflies, which will flash in the same place at the same time and with the same frequency. For a recent introduction to the application of sync, see Johan Suykens & Grigory Osipov, *Introduction to Focus Issue: Synchronization in Complex Networks*, 18 CHAOS, 037101-1, at -1 to -4 (2008).

the development process of a system may also be discontinuous and subject to critical situations, where a minimal perturbation of the situation may give rise to an abrupt catastrophe to the whole system.⁴³ Thus, the unpredictable complexity of a dynamic system can be seen as a result of chaos and of how systems and environments are affected by such chaos.

Throughout the ever-changing development process of a system, intermediary states between total chaos and complete order are the norm.⁴⁴ In fact, a system is at the edge of chaos most of the time.⁴⁵ This may not necessarily be inimical for the development of a system. A system at equilibrium does not have sufficient energy to engender changes in response to alterations in its environment and may thus degrade into death.⁴⁶ Nor is it desirable that a system is in total chaos, as these scenarios are typically characterized by a failure to function as an organized system as a result of a proliferation of uncertainty. An appropriate combination of chaos, emergence, and catastrophe thus helps the system keep an adaptable healthy status.⁴⁷ On this, Rihani states:

Too few states produce unvarying order and too many create chaos: both are dead ends. Poised between the two regimes, Complexity is the zone where self-organization allows new stable patterns to emerge and evolve without compromising the survival of the entire system. In all cases the system must

43. For a specific discussion of chaos, emergence, and catastrophe and their application in understanding environmental law and the broader law-and-society system, see J.B. Ruhl, *Complexity Theory as a Paradigm for the Dynamical Law-and-Society System: A Wake-up Call for Legal Reductionism and the Modern Administrative State*, 45 DUKE L.J. 849, 875–93 (1997).

44. This idea is widely attributed to Chris Langton, *Computation at the Edge of Chaos: Phase Transitions and Emergent Computation*, 42 PHYSICA D 12 (1990). See also Ruhl, *supra* note 18, at 1418.

45. See Langton, *supra* note 44; Ruhl, *supra* note 18, at 1418.

46. See RIHANI, *supra* note 15, at 80.

47. Fryer contends that the most productive state is at the edge of chaos, where maximum variety and creativity provides possibilities of behavior. See Peter Fryer, *A Brief Description of Complex Adaptive Systems and Complexity Theory*, TROJAN MICE <http://www.trojanmice.com/articles/complexadaptivesystems.htm> (last visited Aug. 24, 2013).

have some variety to give it flexibility to withstand unexpected shocks, but limits on variety are also necessary to avoid chaos.⁴⁸

In sum, chaos cannot be avoided. Instead, it is internalized into the dynamic governance scheme of a system. The unanticipated emergence of quality at the level of a system implies that a whole system cannot be intuitively understood simply through the identification of individual elements. Accordingly, it is inadvisable to make *ex ante* projections of the development of a whole system on the basis of our knowledge of individual elements or any subsystem only. Instead, the non-linear interaction characteristic of co-evolution should be introduced to liberate us from the established constraints of traditional wisdom.

2. Adaptability

The second characteristic of a social system is its adaptability. In order to describe the adaptation at detailed levels, Stuart Kauffman introduced the concept of fitness landscapes, which consist of all possible survival strategies (trajectories) of agents within a system.⁴⁹ Normally, the fitness landscape of an agent is full of peaks, valleys, and planes, indicating that the development path of the agent is not always a simple upward slope to the maximum of the system.⁵⁰ However, because no agent has a "God's eye view of its entire fitness landscape,"⁵¹ an agent spends most of his time searching for the local extremum, which may not necessarily be the global maximum.⁵² In addition,

48. RIHANI, *supra* note 15, at 80.

49. STUART A. KAUFFMAN, *THE ORIGINS OF ORDER: SELF-ORGANIZATION AND SELECTION IN EVOLUTION* (1993).

50. The concept was first employed to understand the dynamics of evolutionary optimization. A brief introduction on the concept of the fitness landscape can be seen in Peter Stadler, *Fitness Landscapes*, in *BIOLOGICAL EVOLUTION AND STATISTICAL PHYSICS* 187 (Michael Lässig & Angelo Valleriani eds., 2002). For the application of the concept to legal studies, see Ruhl, *supra* note 18.

51. For a brief review of the history of how social scientists accept Darwinian evolutionary theory, see Ruhl, *supra* note 18, at 1450.

52. A local extremum is the best situation of a subsystem whereas a global maximum may be understood as the best situation of the social system as a whole.

given that the coevolution between a system and the environment the system is embedded in, the fitness landscape is said to have a fluid nature.⁵³ In turn, a search for a nearby peak may itself be time consuming and risky, as moving out of the current niche may court further unexpected risks; for instance, falling into a low-point or simply running on vast plateaus, both of which are worse than the option to remain at its current level. In other words, neither is it effortless for an agent to climb up to a local extremum, nor is it an easy decision for an agent to move out of the niche and search for a higher peak once he stays on a local peak.⁵⁴

One inference from the above understanding is that if it is unknown when and where we can find the global peak, more meaningful trials by agents shall be promoted to achieve the more efficient and effective adaptation of the system as a whole. Given that the sensitivity to the initial situation largely limits the efficacy of a learning process from a foreign environment, it is advisable to promote the learning process between agents with similar, if not identical, initial situations.

Such understanding can conveniently be observed in how the trial-and-error approach to introducing new policies has been gradually institutionalized in China. For instance, private initiatives to get rid of poverty initially succeeded in rural China.⁵⁵ Cosseted by the local and central governments, the initial successful efforts largely invigorated similar experimentation across the whole country.⁵⁶ In consequence, Township and Village Enterprises (“TVEs”) in rural China contributed to economic growth, a result that Deng Xiaoping and his cohorts had not foreseen.⁵⁷ Once the benefits of these local experiments

53. See RIHANI, *supra* note 15, at 82.

54. See Ruhl, *supra* note 18, at 1456–57.

55. Cheng-Gang Xu, *The Institutional Foundations of China's Reforms and Development* 45–46 (Ctr. for Econ. Res. Discussion Paper No. DP7654, May 2008), available at <http://ssrn.com/abstract=1547574>.

56. See *id.* at 15–17.

57. In a meeting with the guests from Yugoslavia on June 12, 1987, Deng said: “The greatest achievement that was totally unexpected is that rural enterprises [both TVEs and private enterprises] have developed.” Yingyi Qian, *The Process of China's Market Transition, 1978–1998: The Evolutionary, Historical, and Comparative Perspectives*, in CHINA'S DEEP REFORM: DOMESTIC POLITICS IN TRANSITION 229, 237 (Lowell Dittmer & Guoli Liu eds., 2006); see

were realized, the Chinese central government introduced new policies by promoting the successful experiences within larger areas.⁵⁸

On the whole, CAS theorists observe that the adaptation path of a system is set by attractors, which refer to "the closed set of states a system repeatedly traverses at equilibrium,"⁵⁹ and attractor basins, which refer to "the wider set of states [a system] can pass through while still returning to its attractor."⁶⁰ Each system may have different states of equilibrium but each state of equilibrium has its own idiosyncratic combination of attractors and attractor basins.⁶¹ The change of a system from one equilibrium state to another is not easy, as the existence of such attractors and attractor basins makes it hard for the system to escape the attraction of existing attractors.⁶² Indeed, even though internal variations happen all the time, a system remains stable in the sense that the whole system cannot easily shift into another global pattern attracted by another set of attractors or attractor basins.⁶³

Due to the existence of attractors and attractor basins, a CAS is resilient in the sense that a system has the ability to absorb disturbances and reorganize so as to stay in the same basin of attraction.⁶⁴ Resilient CASs have adaptive capacities, a concept

also Ying Fan, N. Chen & D.A. Kirby, *Chinese Peasant Entrepreneurs: An Examination of Township and Village Enterprises in Rural China*, 34 J. SMALL BUS. MGMT. 72 (1996). As Deng admitted, the result "just came out of nowhere." MICHAEL ELLMAN, SOCIALIST PLANNING 72 (Phyllis Dean et al. eds., 2d ed. 1989).

58. See Xu, *supra* note 55, at 45–48.

59. See *supra* text accompanying note 18.

60. See Hooker, *supra* note 18, at 24. Hooker employs an example of a ball rolling in a basin. The point at the bottom where the ball may stop is a point attractor. If the ball keeps running around the basin wall without falling into a point at the bottom, then there is a cyclic attractor. A strange chaotic attractor exists in a non-linear complex system; the famous one is Lorenz's butterfly effect.

61. Indeed, "the attractor landscape is the system's dynamical signature." See Hooker, *supra* note 18, at 24.

62. See *supra* text accompanying note 18.

63. *Id.*

64. See generally Brian Walker, C.S. Holling, Stephen R. Carpenter & Ann Kinzig, *Resilience, Adaptability and Transformability in Social-Ecological*

which refers to the ability of a system to “sense threats to system equilibrium and respond by changing resilience strategies without changing fundamental attributes of the system.”⁶⁵ In comparison with the traditional wisdom that law provides certainty, conceptualizing a legal system as a CAS emphasizes how to improve a legal system’s ability to adapt to the ever-changing external environment.⁶⁶

Since different systems have different resilience and adaptive capacities, adaptability will vary from system to system.⁶⁷ The less adaptable or the stickier a system is, the longer period of time it requires to adapt to a new environment.⁶⁸ Among the three systems (legal, political, and economic) being discussed in this Article, the stickiest system is the political system due to the fact that China is still a party state. Conversely, the economic system is the least sticky system.

The implication of such a realization is two-fold. First, the varying adaptability between systems with different degrees of stickiness may contribute to undesirable catastrophes and to the collapse of the whole system.⁶⁹ Thus, the sticky political

Systems, 9 ECOLOGY & SOC. (2004), available at <http://www.ecologyandsociety.org/vol9/iss2/art5/>.

65. J.B. Ruhl, *General Design Principles for Resilience and Adaptive Capacity in Legal Systems—With Applications to Climate Change Adaptation*, 89 N.C. L. REV. 1373, 1387 (2011).

66. *Id.* at 1387–91.

67. Gerard Roland, *Understanding Institutional Change: Fast-Moving and Slow-Moving Institutions*, 38 STUD. COMP. INT’L DEV. 109 (2004). For Roland, the cultural system is the stickiest one, and the legal system and the political system follow in sequence. But since China is a party state, the political system is stickier than the legal system.

68. *Id.*

69. See XUEYI LU, PEILIN LI & GUANGJIN CHEN (陆学艺, 李培林, 陈光金 主编), 2013 NIAN ZHONGGUO SHEHUI XINGSHI FENXI YU YUCE SHEHUI WENXIAN CHUBAN SHE (2013 年中国社会形势分析与预测, 社会科学文献出版社) [2013 CHINA SOCIETAL ANALYSIS AND FORECAST] (2012). According to their report, despite the achievement until the Eighteenth National Congress of the CCP,

[A]t this decisive stage, China needs to further adjust the economic structure, boost domestic consumption, find solutions to growing income inequality, and prevent the rebound of widening income gap. On the other hand, government also needs to pay more attention to adjust the deficiency of the current employment structure, mitigate the tension of labor relationship, and rely on innovative strategies to cope

system may have to be adaptable to the new environment so that sustainable economic growth can be achieved. Second, the time lag may provide opportunities to develop different systems in sequence.⁷⁰ A government may take advantage of the time lag to devote its efforts in developing its economy while passively carrying out reforms of the stickier political system so long as the delay in reform does not degrade the environment. However, the government must take advantage of the time lag tactically, without allowing the political system to drag the greater environment into catastrophe.⁷¹

C. Institutional Compatibility

In essence, both the Systems Theory and the CAS Theory assume an adaptable coevolution between a system and its environment. As shown, the Systems Theory emphasizes operational closure with structural coupling supplementing information from the outside, while the Complexity Theory focuses on the details of adaptation between a system and its environment.⁷²

with emerging characteristics of mass disturbance. Furthermore, it is essential for the government to resolve the resistance during the process of social system reform, strengthen the cooperative mechanism for social management, and change the traditional ideology of maintaining social order with rigid measures.

Id. (as translated by author).

70. Camilo Olaya, *System Dynamics Philosophical Background and Underpinnings*, in 1 COMPLEX SYSTEMS IN FINANCE AND ECONOMETRICS 812, 813 (Robert Meyers ed., 2011 ed. 2010).

71. The catastrophic Chongqing Incident can be cited as evidence. Political errors by Bo Xilai have already been titled as those in the Cultural Revolution. For the implication of the Chongqing Model, see Suisheng Zhao, *The China Model and the Authoritarian State*, E. ASIA FORUM (Aug. 31, 2011), <http://www.eastasiaforum.org/2011/08/31/the-china-model-and-the-authoritarian-state/>. For a comparison of the Guangdong Model and the Chongqing Model, see Dan Steinbock, *Guangdong and Chongqing: Two Sides of the Same Coin*, CHINA US FOCUS (Dec. 11, 2012), <http://www.chinausfocus.com/uncategorized/guangdong-and-chongqing-two-sides-of-the-same-coin/>.

72. International Society for the Systems Sciences ("ISSS") defines a system as "a family of relationships between its members acting as a whole." Matthew Shapiro et al., *The Primer Toolbox*, ISSS.ORG (last visited Aug. 25, 2013), www.iss.org/primer/toolbox.htm. Professor Forrester pointed out, "The con-

The research derived from the foregoing theories thus deviates from the traditional wisdom that focuses on decision making by rational individuals to a new perspective on a network study that considers any given system as a part of some bigger network. A change to any part of the network will thus effect the situation of other aspects of the network and engender unexpected implications on the situation of the whole network. On this point, the argument of Professor Ruhl is pertinent:

The fact of coevolution in dynamical systems is the ultimate demise of reductionism. No one component can be extracted from the system, studied in isolation of the system, altered to fit whatever ideal is in operation for the system, and then inserted back into the system with the expectation that we can predict the subsequent behavior of either the component or the system. The alterations of the one component's schema and structure will reverberate through the system, causing other components to alter their schema and structures, with who knows what as the end result.⁷³

Such understandings may press us for alternative ways to achieve the ultimate objective of the CAS study, which is to determine how to achieve the sustainable growth of the whole system.⁷⁴ Due to the coevolution among systems that constitute an environment, the adaptive capacity of the environment as a whole depends on the compatibility among systems with different adaptive capacities. The objective of how to achieve the sustainable growth of the whole system is then transformed into how to achieve institutional adaptability by building up compatibility of the systems. Different from the prior thinking, efforts shall not be devoted only to improving the resilience and

cept of a system implies interaction and interdependence." See JAY W. FORRESTER, *INDUSTRIAL DYNAMICS*, 347–48 (1961) (quoted in Olaya, *supra* note 70, at 815). Empirical evidence also indicates the interrelationships between and among systems shall be the right target. For instance, in Haggard and Tiede's study of the relationship between economic development and the rule of law, they warn that future studies should pay more attention to the complementarities among rule of law institutions. See Stephan Haggard & Lydia Tiede, *The Rule of Law and Economic Growth: Where Are We?*, 39 *WORLD DEV.* 673 (2011).

73. See Ruhl, *supra* note 18, at 1471 n.245.

74. See Ruhl, *supra* note 18.

adaptive capacity of any independent component system. Rather, compatibility among systems is also, if not more, important to achieve the sustainable growth of the whole system. Given that every CAS is always at the edge of chaos, a dynamic compatibility between systems within an environment is accordingly required.

A relevant study here is the research of Davis on the relationship between institutional flexibility and economic growth.⁷⁵ Davis argues that institutional arrangements must be flexible to accommodate “continual institutional learning and adaptation.”⁷⁶ Davis first differentiates between institutional quality and institutional flexibility, which refers to the ability of creating new institutional arrangements according to environmental development.⁷⁷ Davis found that improvement in institutional quality may have “an immediate but temporary” positive impact on economic growth whereas improvement in institutional flexibility will lead to “a gradual but persistent” economic growth.⁷⁸ Thus, in comparison with institutional quality, institutional flexibility is more meaningful for sustainable economic growth. Good economic institutions, according to Davis, may be sufficient to *maintain* the economy at a given level but do not necessarily *create* high or even positive growth rates of economy.⁷⁹ In addition, Davis observes that “countries with high quality but inflexible institutions will be rich and stagnant, while countries with low quality but flexible institutions will be poor and dynamic.”⁸⁰

For Davis, an emphasis on institutional quality indicates a static view of the institutional environment, which is in conflict with the ever-changing reality of the world.⁸¹ In comparison, the focus on institutional flexibility shall in turn attract aca-

75. Lewis Davis, *Institutional Flexibility and Economic Growth*, 38 J. COMP. ECON. 306 (2010).

76. *Id.* at 318.

77. *Id.*

78. *Id.* (discussing the positive effects of institutional flexibility on the economies of Europe and the United States and the negative effects arising from the lack of institutional flexibility).

79. *Id.* at 307.

80. *Id.*

81. *Id.* at 306.

demographic attention to the “flexible institutional matrix that will adjust in the context of evolving technological and demographic changes.”⁸² Institutional arrangements of a society shall accordingly be established with an objective to achieve adaptive efficiency—“the ability of [a society] to adjust flexibly in the face of shock and evolve institutions that effectively deal with altered reality.”⁸³ This emphasis on dynamic institutional flexibility thus corresponds to the systems theorists’ focus on the coevolution among and between systems.

II. THE SUI GENERIS CHINESE CHARACTERISTICS

Chinese social systems have long been labeled with Chinese characteristics, a clear indicator of autopoiesis of the Systems Theory. According to Professor Zhang, Chinese characteristics refer to two points: Chinese in terms of culture and Socialist in terms of legal and political systems.⁸⁴ In essence, these can be characterized as both Confucian culture and the dominance of the Chinese Communist Party. However, to explore the relationship between law and economic development, a third characteristic was also identified; i.e., the unique central-local relationship.⁸⁵ Each trait will be discussed in sequence.

82. *Id.*

83. Douglass North, *Understanding the Process of Economic Change* 13 (Mercatus Ctr. of George Mason Univ., Forum Series on the Role of Insts. in Promoting Econ. Growth, June 24, 2003), available at http://pdf.usaid.gov/pdf_docs/Pnacx402.pdf. But notice North then deemed China an intriguing exception, for China “does not have the rule of law, it has a political dictatorship; it does not have secure property rights—all of which have under girded the development of the United States and the [W]estern world.” *Id.* at 21.

84. Mo Zhang, *The Socialist Legal System with Chinese Characteristics: China’s Discourse for the Rule of Law and a Bitter Experience*, 24 TEMP. INT’L & COMP. L.J. 1 (2010).

85. I interpret Professor Zhang’s assertion that China is socialist in terms of legal and political systems to mean that the political system, which entails the legal system, is dominated by the CCP. Furthermore, the way that the legal regime interacts with economic policy is defined by a unique relationship between local and central government.

A. Confucianism

The first Chinese characteristic is Confucianism. According to Confucianism, moral virtues are better governance guidelines than laws.⁸⁶ The contrasting philosophy in China is Legalism, according to which formal rules shall be set up beforehand and strictly enforced afterwards.⁸⁷ Under the guidelines of Legalism, rulers are merely professionals who enforce predetermined laws.⁸⁸ Predictability and uniformity are thus commended merits of Legalism. However, Legalism's rigidity attracts vehement criticisms from Confucians, who hold that predetermined rules are doomed to be incomprehensive and unable to deal with the varieties of social life.⁸⁹ Moreover, laws require

86. JIANPAN CHEN, CONFUCIUS AS A TEACHER 266–71 (1994).

87. A good summary of tenets of both Confucianism and Legalism can be seen in D. BODDE, *ESSAYS ON CHINESE CIVILIZATION* (C. LeBlanc & D. Borei eds. 1981) (quoted in David Funk, *Traditional Chinese Jurisprudence: Justifying Li and Fa*, 17 S.U. L. REV. 1, 2–4 nn.4–5 (1990)). See also Eric Orts, *Rule of Law in China*, 34 VAND. J. TRANSNAT'L L. 43 (2001).

88. This is the criticism by Han against Confucianism. For Confucianists,

If you try to guide the common people with coercive regulations and keep them in line with punishments, the common people will become evasive and will have no sense of shame. If, however, you guide them with virtue and keep them in line by means of ritual, the people will have a sense of shame and will rectify themselves.

in *Analects* 2.3; but Han says:

When a sage governs a state, he does not wait for people to be good in deference to him. Instead, he creates a situation in which people find it impossible to do wrong. If you wait for people to be good in deference to you, you will find that there are no more than ten good people within the borders of your state. But if you create a situation in which people find it impossible to do wrong, the entire state can be brought into compliance. In governing, one must use what works in most cases and abandon what works in only a few cases. Therefore, the sage does not work on his virtue, he works on his laws.

Quoted in Eric Hutton, *Han Feizi's Criticism of Confucianism and Its Implications for Virtue Ethics*, 5 J. MORAL PHIL. 423, 428 (2008).

89. 'Li' is a concept with a wide range of meaning, which may include: 1) the narrowest—ritual or rites; (2) the broader—proper conduct; (3) all the institutions and relationships. Thus, Bodde argues that "li, in short, constitute both the concrete institutions and the accepted modes of behavior in a civilized state." And "fa is a model or standard imposed from above (the heaven), to

human beings to set up and enforce them, such that the ideal sought by legalists may be distorted by the people who construct the system.⁹⁰ The conquest of Confucianism over Legalism dates back to the Han Dynasty and shows that governance by laws has historically been downplayed by governance by virtues in China.⁹¹

What is embedded in Confucianism is the impetus to coordinate the interrelationship between individuals.⁹² For Professor Lin, such understanding can be readily identified in one key element of Confucianism represented by the Chinese character “仁.”⁹³ The word itself is defined as “a good interpersonal relationship that is universally valid between two random persons.”⁹⁴ In the words of systems theorists, such an objective can be interpreted as an attempt to constrain chaos to a reasonable extent so as to avoid catastrophes. Thus, Confucianism promotes a shift in focus from rational independent individuals to the interrelationship between individuals, an approach which is inherently in compliance with the Systems Theory approach.

The application of Confucianism in practice is *guanxi*, a widely recognized norm of conduct, which is pervasive in social

which the people must conform.” See Bodde, quoted in Funk, *supra* note 87, nn.15–16.

Laws are created for specific purposes and serve the governor who uses them to control. In contrast, *li*, in compliance with human nature and cosmic order, are characterized by universal validity. Thus, “a government based on *li* functions harmoniously because the *li*, being unwritten, can be flexibly interpreted to meet the exigencies of any particular situation. A government based on law creates contention because its people, knowing in advance what the written law is, can find means to circumvent it, and will rest their sophistical arguments on the letter rather than the spirit of the law.” See Funk, *supra* note 87, at 2–3 n.4.

90. *Id.* at 2–3 n.4. Bodde summarized that “laws are no better than the men who create and execute them.” See note 7 of n.4.

91. In the Han Dynasty, only Confucianism was revered whereas all the other schools were dismissed. See Sor-hoon Tan, *The Dao of Politics: Li (Rituals/Rites) and Laws as Pragmatic Tools of Government*, 61 PHIL. E. & W. 468, 469–71 (2011).

92. Xi Lin, *Adaptive Justice in the Chinese Context: Law Versus Commonsense* (2011), 16 J. CHINESE POL. SCI. 349, 367–70 (2011).

93. *Id.*

94. *Id.* at 367 (citations omitted).

and economic life.⁹⁵ Economically, *guanxi* helps to reduce transaction costs in repeated games.⁹⁶ The implications of *guanxi* in economic activities shall not be deemphasized as transactions are more often made in China on the basis of *guanxi* affiliations than on arm's length principles.⁹⁷ Considering the high frequency of transactions in a fast growing economy, the binding effect of such relational contracts is evident once disputes arise; whereby contractual parties may first seek compensation through long-term contractual relationships set up on *guanxi* to redress losses incurred at an earlier time.⁹⁸

Within such a context of extensive self-enforcing, interlinked relational contracts, the function of the rule of law may in practice be circumscribed given the preference of agents to seek recourse through such norms as *guanxi*. The subconscious preference to avoid being present at courts may also be partly explained by the widely welcomed and long-established tradition of mediation as an important alternative dispute resolution method in China.⁹⁹ Moreover, the inefficient and non-independent judiciary system may also lead disputants to the recourse on non-judiciary solutions.¹⁰⁰

In effect, the emphasis of *guanxi* throughout the history of China promotes a value-based and norm-driven governance

95. Meling Wong, *Guanxi Management as Complex Adaptive Systems: A Case Study of Taiwanese ODI in China*, 91 J. BUS. ETHICS 419, 419–21 (2010). Wong argues that *guanxi* is bound to the five fundamental relationships, i.e., *wulune*—emperor-subject, father-son, husband-wife, elder-younger siblings, and friend-friend. In other words, Wong thinks that all *guanxi* can be interpreted in *wulune*.

96. See Victor Nee, *Norms and Networks in Economic and Organizational Performance*, 88 AM. ECON. REV. 85, 87 (1998); see Wang, *supra* note 1, at 49–50; Anastassios Karayiannis & Aristides Hatzis, *Morality, Social Norms and the Rule of Law as Transaction Cost-Saving Devices: The Case of Ancient Athens*, 33 EUR. J.L. & ECON. 621 (2012).

97. Wong, *supra* note 95, at 421.

98. This is because initial loss may well be recovered and surpassed by the benefits to be acquired in future contracts.

99. See Wang Liming, *Characteristics of China's Mediation System*, 17 ASIA PAC. L. REV. 67, 67–71 (2009).

100. This refers to alternative dispute resolution and political solutions such as *xinfang* (letters and visits), or even protests before the government office building. For letters and visits, see Carl Minzner, *Xinfang: An Alternative to Formal Chinese Legal Institutions*, 42 STAN. J. INT'L L. 103 (2006).

structure.¹⁰¹ It should also be noted that the strong sinicization that stubbornly persisted throughout the history of mainland China may, to this day, effectively shield China from external efforts for a change to Western culture.¹⁰² In fact, despite the “onslaught of new legal and commercial regimes,” *guanxi* practices have even been flourishing in business transactions.¹⁰³ Hence, the long-established informal norms of *guanxi* continue to have an important role in social activities in China. Nevertheless, these important informal norms shall not be employed to minimize the role of law, but rather to seek the right combination between the soft norm and the hard law.¹⁰⁴

B. The Dominance of the CCP

The second characteristic is the dominance of the CCP control, which can be reflected in both the omnipresence of the CCP and the hierarchical Nomenklatura personnel management system.

1. The Omnipresence of the CCP

The structure of the Chinese political system is better described as a hierarchical structure with the leading CCP on the top and several democratic parties playing consultative roles and showing full support for the leadership of the CCP.¹⁰⁵

101. Alex Chan & Angus Young, *Chinese Corporate Governance Regime from a Historical-Cultural Perspective: Rethinking Confucian System of Governance* (Oct. 3, 2012) (unpublished manuscript), available at www.ssrn.com/abstract=2156300.

102. See generally HENRY KISSINGER, ON CHINA (2011).

103. Mayfair Mei-hui Yang, *The Resilience of Guanxi and Its New Developments: A Critique of Some New Guanxi Scholarship*, 170 CHINA Q. 459, 459 (2002).

104. Orly Lobel, *Setting the Agenda for New Governance Research*, 89 MINN. L. REV. 498, 506 (2004).

105. Official introduction to the political system of China:

China's political system is a system of multi-party cooperation and political consultation under the leadership of the Communist Party of China (CPC). The system was established and developed jointly by the CPC and other democratic parties in their longtime commitments to China's revolution, its construction and reforms. The system has become a basic political system in contemporary China.

Within such a political governance structure, the omnipresence of the CCP is apparent in a number of ways. First, the CCP is the most populous party with more than 82.6 million party members at the end of 2011.¹⁰⁶ CCP members occupy the majority of the National People's Congress ("NPC") at different levels.¹⁰⁷ Though most non-party members may select to be representatives of the Chinese People Political Consultation Conference ("CPPCC"), their roles are subject to the leadership of the CCP.¹⁰⁸ Also notable is the recently promoted

The CPC-Led Multi-party Cooperation and Political Consultation System,
CRIENGLISH (Sept. 30, 2007),
<http://english.people.com.cn/90002/92169/92211/6275039.html>.

106. Zhou Yingfeng, *The Number of Members of the Chinese Communist Party Reached 82.602 Million at the End of Last Year*, SINA (June 6, 2012), <http://news.sina.com.cn/c/2012-06-30/152224688503.shtml>.

107. From the eighth to tenth NPC, the proportion of the CCP among the representatives of the National People's Congress has been around 70%. Considering that the representatives of National People's Congress are selected from the representatives of Local People Congress, the ratio of CCP among the representatives of Local People's Congress is much higher. See Jiajun Qiu (邱家军), *Renda Daibiao Xuanju Zhong Zhengzhi Baguan Quan de Yunxing Weidu* (人大代表选举中政治把关权的运行维度) [*The Dimension of the Political Check in Electing Representatives of the National People's Congress*], 6 FUDAN ZHENGZHI XUE PINGLUN (《复旦政治学评论》) [FUNDAN UNIV. POL. SCI. REV.] (Mingming Chen ed., 2008). This is the case even though a ratio of 65% was inserted in Zhonggong Zhongyang Guanyu Zuo Hao Difang Geji Renda Huanjie Gongzuo de Tongzhi (中共中央关于做好地方各级人大换届工作的通知) [Notification on Carrying out Election at Expiration of Office Terms] (in September 1992), CPCS (Sept. 24, 1992), available at <http://www.e-cpcs.org/newsinfo.asp?Newsid=10117>.

108. This has been maintained through a series of documents from the party. The widely referred to sources include the Opinion of the CCP Central Regarding the Insisting on and Perfecting the System of Multiparty Co-Operation and Political Consultation under the Leadership of the CCP in 1989 and the Opinion of the CCP Central Regarding the Further Strengthening of the System of Multiparty Co-operation and Political Consultation under the Leadership of CCP 2005. Zhonggong Zhongyang Guanyu Jianchi he Wanshan Zhongguo Gongchandang Lingdao de Duodang Hezuo he Zhengzhi Xieshang Zhidu de Yijian (中共中央关于坚持和完善中国共产党领导的多党合作和政治协商制度的意见) [Opinion of the CCP Central Regarding the Insisting on and Perfecting the System of Multiparty Co-Operation and Political Consultation under the Leadership of the CCP in 1989], available at <http://cpc.people.com.cn/GB/64107/65708/65722/4444523.html>; Zhonggong Zhongyang Guanyu Jinyibu Jiaqiang Zhongguo Gongchandang Lingdao de

“Three-Represents,” meaning that the CCP represents (1) society’s most advanced productive forces; (2) advanced culture; and (3) the needs and interests of the greatest majority of the Chinese population.¹⁰⁹ This shows that the Party has become more inclusive and expansive than ever in attracting elites with different backgrounds across different classes of society.¹¹⁰ Second, the CCP’s presence is felt in social life through the CCP Constitution, which dictates the establishment of branches of the Party wherever there are three party members in any organization, be it a joint venture, a law firm, a private company, or institutions in the judicial system.¹¹¹ Third, there is a hierarchical structured Political-Legal Committee under the CCP Committees at different levels.¹¹² The members of such com-

Duodang Hezuo he Zhengzhi Xieshang Zhidu Jianshe de Yijian (中共中央关于进一步加强中国共产党领导的多党合作和政治协商制度建设的意见) [Opinion of the CCP Central Committee regarding the Further Strengthening of the System of Multiparty Co-operation and Political Consultation under the Leadership of CCP 2005] (Issued by the Central Committee of the Communist Party of China, Feb. 18, 2005) (China), available at <http://cpc.people.com.cn/GB/64162/71380/102565/182142/10993406.html>.

Zhonggong Zhongyang Guanyu Jiaqiang Renmin Zhengxie Gongzuo de Yijian (中共中央关于加强人民政协工作的意见) [Opinion of the CCP Central regarding the Strengthening of the Work of the System of Multiparty Co-Operation and Political Consultation in 2006], available at <http://cppcc.people.com.cn/GB/34952/4155357.html>; Zhonggong Zhongyang Guanyu Jiaqiang Xinxingshi Xia Dangwai Daibiao Renshi Duiwu Jianshe de Yijian (中共关于加强新形势下党外代表人士队伍建设的意见) [Opinion of the CCP Central Committee regarding the Further Strengthening the Construction of Non-CCP Personnel under the New Situation in 2012]. For a brief review, see Xiaoying Yu, *The History and Trend of the Institutionalization and Normalization of the Multiple Party Cooperation in China*, 6 J. CENT. INST. SOCIALISM 48 (2012).

109. See *Full Text of the Constitution of Communist Party of China*, XINHUANET (Oct. 25, 2007), available at http://news.xinhuanet.com/english/2007-10/25/content_6944738.htm.

110. See Cheng Li, *The Chinese Communist Party: Recruiting and Controlling the New Elites*, 3 J. CURRENT CHINESE AFF. 13, 14–15 (2009).

111. See *Constitution of Communist Party of China*, *supra* note 109, art. 29. Primary Party organizations are formed in enterprises, rural areas, government organs, schools, research institutes, communities, social organizations, companies of the People’s Liberation Army, and other basic units where there are at least three full Party members.

112. See SUSAN V. LAWRENCE & MICHAEL F. MARTIN, CONG. RESEARCH SERV., R41007, UNDERSTANDING CHINA’S POLITICAL SYSTEM (2012), available at

mittees are heads of judiciary organs at different levels, and because judiciaries are supervised by and are responsible for NPC at different levels, the influence of the CCP may in fact undermine the independence of the judicial system.¹¹³

Given the omnipresence of the Party, economic agents in China proactively follow an “if you can’t beat them, join them” approach by seeking opportunities to be elected or attracted as a representative either of the People’s Congress at different levels or of the CPPCC.¹¹⁴ This is a mutually beneficial process. For economic agents, joining in the club with elites who hold strong powers in accumulating and distributing resources provides them with a better chance to take advantage of more insider information.¹¹⁵ Thus, the Party can conveniently achieve the

http://china.usc.edu/App_Images//crs-2012-understanding-china-political-system.pdf.

113. See Fu Hualing, *Autonomy, Courts and the Politico-Legal Order in Contemporary China*, in THE ROUTLEDGE HANDBOOK OF CHINESE CRIMINOLOGY 76–88 (Liquan Cao, Ivan Y. Sun, & Bill Heberton eds., 2013).

114. Currently there is no specific law on CPPCC. However, the preamble to the Constitution of the PRC (XIANFA, 宪法) states:

The Chinese People’s Political Consultative Conference, a broadly based representative organization of the united front which has played a significant historical role, will play a still more important role in the country’s political and social life, in promoting friendship with other countries and in the struggle for socialist modernization and for the reunification and unity of the country.

XIANFA, pmbl. (1982) (China). The members of the CPPCC are selected representatives of different walks of life and with social influence. For a brief summary of the system, see *People’s Political Consultative Conference of the PRC*, UNIV. OF MINN. HUMAN RIGHTS LIBRARY, available at <http://www1.umn.edu/humanrts/research/ppcc.html>.

115. Empirical evidence shows that political connections bring additional benefits to entrepreneurs. Wu et al. found that private firms with politically connected managers perform better and receive more tax benefits from local governments than those without such managers. In addition, politically connected managers are more likely to be assigned to underperforming local State Owned Enterprises. See Wenfeng Wu, Chongfeng Wu, Chunyang Zhou & Jun Wu, *Political Connections, Tax Benefits and Firm Performance: Evidence from China*, 31 J. ACCT. & PUB. POL’Y 277 (2012); Hong Bo, *Political Appointments of Managers in China* (Univ. of London Working Paper, 2009), available at http://csf.kiep.go.kr/download.ddo?type=c&att_seq_n=2377.

political objective of diversified representation of the people and can concurrently enhance its control of the Party.¹¹⁶

Alternatively, the omnipresence of the Party transforms potential political conflicts between the different parties into those between different factions within the Party.¹¹⁷ It is thus reasonable to worry that the intensive conflicts within the Party may lead to its collapse. However, the fact is that short of a hegemonic faction, a rational choice for factions is to cooperate with each other for common benefits. Furthermore, internal improvement and alternation of party leaders help the CCP to avoid the closed style of government observed in Muslim countries and sidestep the potential pitfalls of democracies where the opposing parties do not contribute to meaningful debates, but merely debate to oppose.¹¹⁸ Last but not least, the collective leadership also forestalls the one-man leadership of the past by promoting “considerable bargaining and maneuvering for factional advantage.”¹¹⁹ In other words, neither the similarity among different factions within the Party is strong enough to lead the system into a dying equilibrium, nor is the difference between factions strong enough to lead the system into total chaos.¹²⁰ Instead, efficiency and rationality in decision making may still be enhanced under the one party control system by

116. This is further enhanced in the recent Opinions issued by the CCP Central. See Zhonggong Zhongyang Guanyu Jiaqiang Xinxingshi Xia Dangwai Daibiao Renshi Duiwu Jianshe de Yijian (中共关于加强新形势下党外代表人士队伍建设的意见) [Opinion of the CCP Central Committee regarding the Further Strengthening the Construction of Non-CCP Personnel under the New Situation in 2012]; Zhonggong Zhongyang Guanyu Jinyibu Jiaqian Dangguan Rencai Gongzuo de Yijian (中共中央关于进一步加强党管人才工作的意见) [Opinion of the CCP Central Committee regarding the Further Strengthening the Work of Control of Talents by the CCP], available at <http://cpc.people.com.cn/BIG5/n/2012/0926/c64387-19120321.html>.

117. See Zheng Yongnian, *Why the Chinese Communist Party Will Not Collapse*, STRAIT TIMES, Sept. 12 2012, at A23, available at <http://newshub.nus.edu.sg/news/1209/PDF/CHINESE-st-12sep-pA23.pdf>.

118. *Id.*

119. LAWRENCE & MARTIN, *supra* note 112.

120. This is not to say that internal democracy has already achieved its desired efficacy. For instance, self-monitoring has been far from satisfactory, which in turn seriously undermines the efficacy of the internal democracy.

both expanding the wide coverage of party members and promoting internal democracy within the Party.¹²¹

2. The Nomenklatura System

The dominance of the CCP is further enhanced by the institutionalized Nomenklatura system. Transplanted from the former Soviet Union, the Nomenklatura system refers to the institutional arrangements on personnel management through which the Party has the power to decide the list of potential candidates for key positions, both in the government and the party's own hierarchy, as well as to nominate qualified personnel.¹²² Since 1980, the system has been extended to party committees at lower levels.¹²³

The Nomenklatura system covers a wide range of personnel—from political positions to positions in judiciary organs, academic institutions, and enterprises.¹²⁴ For instance, judges in the judiciary system and directors of state-owned enterprises (“SOEs”) are all covered by the Nomenklatura scheme.¹²⁵ On the one hand, they are party members and regulated by the Nomenklatura scheme.¹²⁶ On the other hand, they must per-

121. See Zheng, *supra* note 117.

122. John Burns, *China's Nomenklatura System*, 36 PROBS. COMMUNISM 36, 36 (1987).

123. Central Committee Organization Department, “Notice on the Repromulgation of the Job Title List of Cadres Managed by the Party Central Committee, 1980,” in which the Party committees at lower levels were also required to do the same. See Burns, *supra* note 122, at 37.

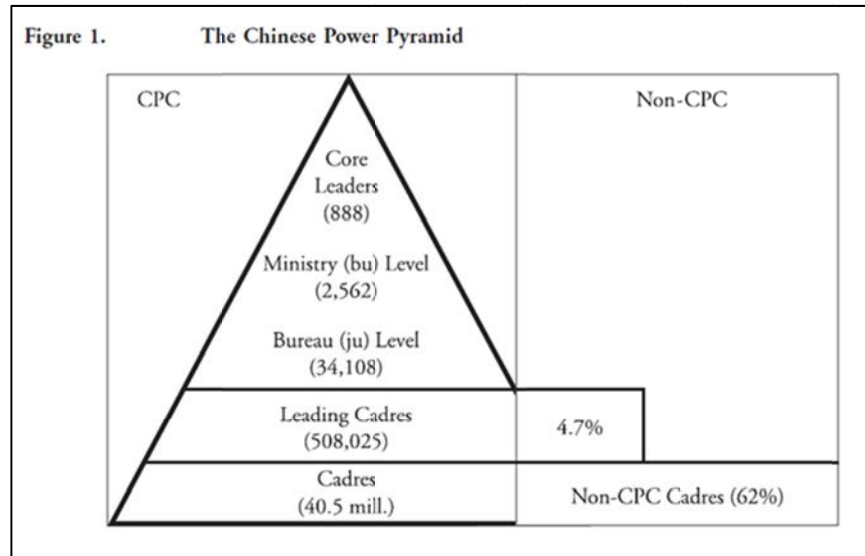
124. For a list of the job titles covered, see Burns, *supra* note 122 at 42–45. A relevant concept is *BianZhi*, which is usually translated as “establishment.” The two concepts are different. *BianZhi* clarifies what departments and positions are included in an administrative setup whereas the Nomenklatura system tells which job titles are under the party control. See Kjeld Brødsgaard, *Cadre and Personnel Management in the CPC*, 10 CHINA: INT'L J. 69, 76 (2012).

125. For the list of job titles covered by the Nomenklature System, see Burns, *supra* note 122 at 42–45.

126. See Burns, *supra* note 122; see also Hon S. Chan, *Cadre Personnel Management in China: The Nomenklatura System, 1990–1998*, 2004 CHINA Q. 703 (2004). The so-called cadres must be “both red and professional,” or both politically adamant and technically professional (you hong you zhuan, 又红又专). See Fengcheng Yang (楊凤城), *Guanyu “You Hong You Zhuan” Wenti de Lishi Pingjia* (关于“又红又专”问题的历史评价) [A Historical Review of the

form their specific professional functions either in courts or in the SOEs.¹²⁷ In turn, the promotion of such personnel is made on the basis of both their professional performance and their contribution to the Party.¹²⁸ Thus, by integrating the Party's policies into the performance evaluation criteria of people under the scheme, the Nomenklatura scheme can effectively enhance the control of the Party on both the economic and legal system.

The extensiveness and effectiveness of the Party control through the Nomenklatura scheme can easily be identified in the following diagram:¹²⁹



Source: Kjeld Brødsgaard, *Cadre and Personnel Management in the CPC* (2012).

Issue of "Both Politically Adamant and Technically Professional", 4 «中共党史研究» [RES. HIST. CCP] 56 (1997).

127. See generally Chan, *supra* note 126.

128. Andrew G. Walder, Bobai Li & Donald J. Treiman, *Politics and Life Chances in a State Socialist Regime: Dual Career Paths into the Urban Chinese Elite, 1949–1996*, 65 AM. SOC. REV. 191, 192–206 (2000); Li, *supra* note 110, at 17–19.

129. See Brødsgaard, *supra* note 124, at 75.

As shown, non-party leaders cannot be found in ranks higher than the Bureau Level. It is fair to say that the Nomenklatura system today helps the Party achieve a highly controlled personnel administration system with an extensive coverage, the role of which cannot be minimized due to "its importance for the Party patronage and social stability."¹³⁰ A combined reading of the omnipresence of the Party and the Nomenklatura system tells us that a unified central leadership with a level-by-level hierarchical structure has been institutionalized not only within the Party but also in the wider administrative system of government.¹³¹

3. Adaptation of the Party

The omnipresence of the Party and the strong personnel control under the Nomenklatura system not only helps to establish and uphold the leading position of the political system among the three systems of China, but also fosters a very strong operational closure of the CCP-dominated political system. Internally, the structural coupling of the political system with the other two systems shows a one-way radiation. As shown in the Constitution, the single-party controlled political system demands both a national economy dominated by state-owned economy and a legal system serving the policies and interests of the Party.¹³² Conversely, the influence of the economic and legal systems on the reform of the political system is limited.¹³³

Externally, the structural coupling of the Chinese political system with the political system of other countries is rather

130. Despite a short break during the Cultural Revolution period, the scheme has long been in existence. During the period of the Cultural Revolution, the intensive conflict within the party incapacitated the functioning of the system. John P. Burns, "Downsizing" the Chinese State: Government Retrenchment in the 1990s, 175 CHINA Q. 775, 802 (2003).

131. Lisheng Dong, *Central-Local Relations in China: Retrospect and Prospect* (Univ. of Nottingham, China Pol'y Inst., Discussion Paper No. 16, 2007), available at <http://www.nottingham.ac.uk/cpi/documents/discussion-papers/discussion-paper-16-central-local-relations.pdf>.

132. See XIANFA, pmbl., arts. 1, 5, 6 (1982) (China).

133. See Joseph Cheng, *China: Little to No Political Reform*, EAST ASIA FORUM (Oct. 11, 2011), <http://www.eastasiaforum.org/2011/10/11/china-little-to-no-political-reform/>.

weak and again manifests itself in a one-way mode by radiating outward.¹³⁴ In fact, the experience of the former Soviet Union during the transition at the end of the 1980s taught China a lesson on how not to act—the Soviet Union's abrupt and simple change of its system without a complementary socio-political environment resulted in a bitter experience.¹³⁵

It is true that the development of the legal and economic systems may impose more intensive pressure on substantive reform of the political system.¹³⁶ Still, the amount of delay needed to effect changes may also save enough time for the Party to reform from within. In fact, the Party has been undergoing adaptable reform.¹³⁷ For instance, inner-party democracy has been promoted ever since Mao's era and deemed the "lifeblood of the Party."¹³⁸ By introducing such measures as multi-candidate

134. This is in the sense that the structure of the Chinese political system is stubbornly resistant to external pressures. The Chairman of the National People's Congress Standing Committee, Bangguo Wu, stated that China will not follow the Western path and would prefer a "no political change" policy. See Zheng Yongnian, *Where Does the Chinese Communist Party Go from Here?: Challenges and Opportunities*, 10 CHINA: INT'L J. 84, 85 (2012). Professor Zheng argues that the CCP is rather open internally but closed externally. The internal openness is achieved by intra-party democracy.

135. See generally Popov, *supra* note 6.

136. As quoted by LI, a survey of 80,000 people conducted by the Organization Department of the CCP in 2008 showed that one third of the Chinese populace was not happy with the way the CCP leaders were selected or the performance of the CCP leaders. See Cheng Li, *Intra-Party Democracy in China: Should We Take It Seriously?*, CHINA LEADERSHIP MONITOR, Fall 2009, at 12, available at <http://media.hoover.org/sites/default/files/documents/CLM30CL.pdf>.

137. For that, Nathan's summarization is apt:

[F]our aspects of the CCP regime's institutionalization: 1) the increasingly norm-bound nature of its succession politics; 2) the increase in meritocratic as opposed to factional considerations in the promotion of political elites; 3) the differentiation and functional specialization of institutions within the regime; and 4) the establishment of institutions for political participation and appeal that strengthen the CCP's legitimacy among the public at large.

See Andrew Nathan, *Authoritarian Resilience*, 14 J. DEMOCRACY 6, 6–7 (2003).

138. The phrase was introduced on the 16th Party Congress in 2002. For a critical review of the Inner-Party Democracy, see Joseph Fewsmith, *Inner-Party Democracy: Development and Limitations*, CHINA LEADERSHIP

elections, decision making by votes, and institutionalized management of the cadres, it is expected to achieve a more transparent Party life.¹³⁹ In addition, the collective leadership invigorates dynamic factional politics, with the result that internal democracy may lead to greater institutionalization of the inner-party democracy, thus further enhancing the Party's control.¹⁴⁰ As one professor observed, "China has not moved away from socialism, but has rather kept the socialist brand and applied it in a more expansive way."¹⁴¹

The end result of such a nearly single-direction structural coupling may well be a stultified political system, which may further hinder or destroy the progress made in the economic system and the legal system. For instance, even though political and social reform had already begun since the 16th CCP Congress in 2002, the reform is to a large extent aimed at supplementing or complementing the results achieved by economic reform and perfecting the environment for economic reform.¹⁴² However, as Premier Wen once warned: "Without the success of political structural reform, it is impossible for us to fully insti-

MONITOR, Winter 2010, at 9–10, available at <http://media.hoover.org/sites/default/files/documents/CLM31JF.pdf>; Li, *supra* note 136, at 2, 7. Li argues that the Inner Party Democracy is not merely rhetoric, and the concrete steps implemented until now may further invigorate the party. Meanwhile Fewsmith warns that monitoring from below may not be possible if the current cadre management scheme is in place as following orders from above is rewarded whereas responding to the demands of below is downsized. Fewsmith further projects that the inner party may well function as a passive response to the critical situations rather than a proactive reform from within, as the term indicates.

139. See generally Zheng, *supra* note 134.

140. See Li, *supra* note 136, at 7–8.

141. See Zhang, *supra* note 84, at 53.

142. This is still the case after the promulgation of the Resolution on Several Key Issues in Comprehensively Deepening the Reform on the third Plenum of the Eighteenth CCP Committee. See Zhuoyuan Zhang, *The Key to Comprehensively Deepen the Reform is the Reform of Economic System*, CHINA SOC. SCI. TODAY, Nov. 27, 2013, available at <http://www.csstoday.net/xueshuzixun/guoneixinwen/86239.html>. Even though a radical political reform was not possible, as what happened in the former Soviet Union, the reform in political system has been introduced at times when the political system severely constrains the development of economy.

tute economic structural reform.”¹⁴³ Viewed from this perspective, the adaptation of the political system is relatively passive rather than proactive.¹⁴⁴

C. The Symbiosis of Strong Central Control and Gradual Deregulation

Strong central control is the third sui generis Chinese characteristic to address. At the time when the country was founded, the objective to develop heavy industry, the necessity to guarantee agricultural provisions and supplies, and the requirement to supply public goods all made centralization both economically and politically indispensable.¹⁴⁵ However, the heavy workload at the central government and the unnecessary complications arising from the information asymmetry under the command economy led to decentralization in 1957.¹⁴⁶ However, serious

143. *Premier Wen Jiabao Meets the Press*, EMBASSY OF THE PEOPLE'S REPUBLIC OF CHINA IN THE REPUBLIC OF GHANA (Mar. 15, 2012), <http://gh.china-embassy.org/eng/xwdt/t915342.htm>. See also Minxin Pei, *China: Can Economic Growth Continue Without Political Reform?*, in STRATEGIC ASIA 2006-07: TRADE, INTERDEPENDENCE, AND SECURITY 303 (Ashley J. Tellis & Michael Wills eds., 2007).

144. See Zheng Yongnian, *China, an Emerging Power, Is Exploring Its Own Development Model*, CHINA ECONOMIST (forthcoming 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532106.

145. For a detailed discussion of the cycles of deregulation and centralization and the implications on the development of China, see Yifu Lin, Ran Tao & Mingxing Liu, *Decentralization and Local Governance in China's Economic Transition*, in DECENTRALIZATION AND LOCAL GOVERNANCE IN DEVELOPING COUNTRIES 305, 307 (Pranab Bardhan & Dilip Mookherjee eds., 2006). See also Chunli Shen, Jing Jin & Heng-fu Zou, *Fiscal Decentralization in China: History, Impact, Challenges and Next Steps*, 13 ANNALS ECON. & FIN. 1 (2012). For Shen et al., the fiscal reform in Chinese history can largely be divided into the central control system (1949–1978), the fiscal contracting system (1978–1993), and the later tax-sharing system (1994–present).

146. See Justin Yifu Lin, Ran Tao & Mingxing Liu, *Decentralization, Deregulation and China's Growth in Transition*, in LAW AND ECONOMICS WITH CHINESE CHARACTERISTICS: INSTITUTIONS FOR PROMOTING DEVELOPMENT IN THE TWENTY-FIRST CENTURY 467, 468–71 (David Kennedy & Joseph E. Stiglitz eds., 2013). The Third Plenary Session of the 8th Congress of the Communist Party of China serves as an indicator of the first wave of decentralization by delegation of more power from the central to the local governments. Specific measures included the delegation of nearly all SOEs to local governments; planning on a regional basis was given preference over central planning on a

coordination failures called for centralization again only two years later.¹⁴⁷ The ensuing economic stagnation reignited efforts to decentralize in the 1970s and, in turn, the investment boom arising from discretions at local levels resulted in another round of centralization.¹⁴⁸

As before, the re-centralized governance structure was again identified as one of the main obstacles to economic development at the beginning of reform.¹⁴⁹ Deregulation had since been promoted to liberate productivity.¹⁵⁰ As one main technique to deregulation, fiscal reform carried out in 1980 required local governments to seek the fiscal balance on their own.¹⁵¹ Local governments then began to do their utmost to promote economic development, resulting in self-contained and sufficiently diversified provincial economies, which indicate that intensive competition among different provinces may persist.¹⁵²

By invigorating local economies through inter-provincial competition, deregulation has contributed to astonishing eco-

national basis; a five-year revenue sharing scheme was introduced along with enhanced local tax authority.

147. *Id.*

148. *Id.* This is the so-called second wave of decentralization, the indicator of which is the 3rd Plenary Session of the 11th CPC Congress in December 1978. Several features were similar to those of the first wave of decentralization.

149. See *Communique of the Third Plenary Session of the Eleventh CPC Central Committee*, BEIJING NEWS (Oct. 10, 2008), http://www.bjreview.com.cn/special/third_plenum_17thcpc/txt/2008-10/10/content_156226.htm.

150. *Id.*

151. See Shen et al., *supra* note 145. This is the “fiscal contracting system” between 1980 and 1985, through which revenue and expenditure were divided between the central and local governments and each local government was given responsibility for balancing its own budget. Taxes were accordingly categorized into the central government revenue, and revenues were shared according to a prefixed proportion between the central and the local governments. In 1985, the measure of profit remittance to the government by SOEs was replaced by that of income taxation.

152. Shen Liren (沈立人), Dai Yuanchen (戴园晨), *Woguo Zhuhou Jingji de Xingcheng ji Qi Biduan he Genyuan* (我国“诸侯经济”的形成及其弊端和根源) [*Formation, Defect and Origin of “the Economy Divided by Dukes or Princes under Emperor” in China*], 3 *ECON. RES. J.* 12 (1990); Alwyn Young, *The Razor’s Edge: Distortions and Incremental Reform in the People’s Republic of China*, 115 *Q.J. ECON.* 1091, 1105 (2000).

conomic growth.¹⁵³ However, the imbalance between the central and local governments imposed a serious threat on the authority of the central government, and centralization was re-ordered in 1994.¹⁵⁴ Indeed, the whole picture is better understood as “cycles of centralization and deregulation,” throughout which the central government has been holding the ultimate say on the timing and extent of deregulation.¹⁵⁵ Thus, even though deregulation to local governments can be seen as a main feature of recent administrative reform, local discretion has always been subject to review from the strong center.¹⁵⁶

Considering the discretion enjoyed by local governments, the power of the central government is of special importance in China. First, strong central control provides an effective mechanism for structural coupling between local governments, which enjoy discretion that provides many opportunities for experimentation.¹⁵⁷ This strong central control can limit the effects of experiments within the constraints established by the central government, enabling successful experiences to be extended to a wider scope, with negative effects arising from unsuccessful experiments accordingly limited to experiment points.¹⁵⁸ Second, the central control aids in fighting against unpredictable crises, a feature that is especially important given the fitness landscape of a fast growing economy. For instance,

153. See Lin et al., *supra* note 146, at 484–86.

154. Shen et al., *supra* note 145, at 8–11.

155. Cunyi Yin (殷存毅) & Nengli Xia (夏能礼), “Fangquan” huo “Fen Quan”: Woguo Yang—Di Guanxi Chu Lun (“放权”或“分权”: 我国央—地关系初论) [Deconcentration or Decentralization: On the Relationship Between the Central and the Local Government in China], 12 «公共管理评论» [CHINA PUB. ADMIN. REV.] 23 (2012).

156. Hongbin Cai & Daniel Treisman, *Did Government Decentralization Cause China's Economic Miracle?*, 58 WORLD POL. 505, 507–08 (2006).

157. See Sebastian Heilmann, *Maximum Tinkering under Uncertainty: Unorthodox Lessons from China*, 35 MOD. CHINA 450, 457 (2009). But see Cai & Treisman, *supra* note 156. According to Cai and Treisman, it is the competition at the center among factions with different ideological predispositions and local connections rather than the competition among locals that explains the economic growth. This view however does not change the argument that it is the trials at the local level that provide the dynamic to adapt to a point of efficiency.

158. Sebastian Heilmann, *From Local Experiments to National Policy: The Origins of China's Distinctive Policy Process*, 59 CHINA J. 1, 2 (2008).

the CCP Politburo met in October 2008, immediately after the collapse of Lehman Brothers, and released its economic stimulus package worth 4 trillion RMB in November 2008.¹⁵⁹ An effective control from the central government thus secures the effective intervention required for speedy effective solutions. Third, a strong central government is essential for achieving the objective of fast growth per se, in terms of accumulating and distributing resources in a weak market economy while securing a stable environment for the adaptation of the whole system. For instance, the highly centralized planned economy helped China at the foundation of the country build its heavy industry, guarantee supply and procurement of grain, and provide public goods.¹⁶⁰ Similarly, it is also the strong central control that transferred the wealth accumulated from the TVEs to avoid widespread unemployment for numerous employees of the SOEs, thus saving time for the ensuing reforms.¹⁶¹ Likewise, a strong central control is also necessary for securing a stable environment, in which the country can initiate and continue its economic reforms.¹⁶² Thus, the strong central control in combination with the gradual deregulation to local governments provides a suitable strategy to achieve the adaptive efficiency of the whole system.

159. *China's 4 Trillion Yuan Stimulus to Boost Economy, Domestic Demand*, XINHUANET (Nov. 9, 2011), http://news.xinhuanet.com/english/2008-11/09/content_10331324.htm.

160. See Lin et al., *supra* note 145.

161. Fan Gang, *Incremental Changes and Dual-Track Transition: Understanding the Case of China*, 9 ECON. POL'Y 99, 109–10 (1994).

162. Dam argues that the continuation of leadership in China saved China from the potential pitfalls arising from Eastern European countries. Kenneth W. Dam, *China as a Test Case: Is the Rule of Law Essential for Economic Growth?* 34–35 (Univ. of Chi. Law Sch., John M. Olin Law & Econ. Working Paper Series, Working Paper No. 275, 2006), available at <http://ssrn.com/abstract=880125>.

III. IMPLICATIONS ON THE ADAPTATION OF THE LEGAL SYSTEM

A. *Adaptation of the Legal System*

1. Adaptation with the Dominant Political system

In stark contrast to the checks and balances scheme in the West, analyzing China's one-party political system is integral to understanding Chinese legal development. Since the immediate and overarching political system overshadows the legal and economic development, the structural coupling between the political system and the legal system is almost always one way. In fact, the paramount dominance of the Party in the judiciary system can be observed in terms of finance, personnel, and operation.¹⁶³ For instance, local governments finance local courts, and most members of the Adjudicative Committee in each court, a Committee which is in charge of influential cases, are CCP members.¹⁶⁴ In combination with long-established social *guanxi*, the intrusion of politics seriously undermines the independence of the court system.¹⁶⁵

Alternatively, the lack of confidence in the judiciary system drives disputants directly to the government for a solution. As the populace inherently thinks the government is the ultimate settler of disputes, the populace may intentionally sidestep the legal system.¹⁶⁶ This is especially true when cases deal with

163. Ignazio Castellucci, *Rule of Law with Chinese Characteristics*, 13 ANN. SURV. INT'L & COMP. L. 35, 56 (2007).

164. See ALBERT CHEN, AN INTRODUCTION TO THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA 201-03 (4th ed. 2011). According to Article 11 of the Organic Law of the People's Courts 1979, a Judicial Committee shall be established in each court by the standing committee of the relevant People's Congress. *Organic Law of the People's Courts of the People's Republic of China*, CHINA.ORG.CN, <http://www.china.org.cn/english/government/207253.htm> (last visited Jan. 12, 2014). The membership of a basic People's Court is comprised of a president, vice presidents, and judges. *Id.*

165. Jerome A. Cohen, *Network Solutions*, S. CHINA MORNING POST (Mar. 4, 2010), <http://www.scmp.com/print/article/707506/network-solutions>.

166. The letter and visit is one field example. For a critical view of the letter and visit in China, see Minzner, *supra* note 100, at 105; see also Carl Minzner, *China's Turn Against Law*, 59 AM. J. COMP. L. 935, 938 (2011).

sensitive sociopolitical and socioeconomic issues.¹⁶⁷ Additionally, the Party's policies may easily be integrated into laws and regulations wherever ambiguous existing laws and regulations leave opportunities for the Party to intervene.¹⁶⁸ In combination with these elements, the Nomenklatura scheme and the increasingly expansive party membership enhance the enforceability in social life of Party policies, which may in fact function as a "living constitution."¹⁶⁹ Just as one scholar properly argues, the Chinese legal system can only be appropriately understood with its indispensable political element.¹⁷⁰

Thus, in comparison with the rather autonomous nature of legal systems in Western society, the operational closure of the legal system within China may have to be constrained, if not handicapped, by its nearly one-way structural coupling with the leading political system.

Besides, the dominance of the political system in China also implies a delicate adaptation of the legal system. The recently promoted Three-Supremes—meaning "the supremacy of the Party, the supremacy of popular interests, and the supremacy of the Constitution and law"—within the judiciary system can be cited as a revealing example here.¹⁷¹ As an echo to the Three-Represents and the pursuit to establish a harmonious state, the president of the Supreme People's Court proffered the Three Supremes.¹⁷² On the one hand, the three-supremacy

167. Fu and Peerenboom tried to tell the difference between political cases ("directly challenging the authority of the ruling regime"), politically sensitive cases ("affect[ing] socio-political stability, economic growth, international recognition or reputation or the broad public interest") and labor cases (using collective and different dispute resolution procedures). Fu Yulin & Randall Peerenboom, *A New Analytical Framework for Understanding and Promoting Judicial Independence in China*, in JUDICIAL INDEPENDENCE IN CHINA: LESSONS FOR GLOBAL RULE OF LAW PROMOTION 95–133 (Randall Peerenboom ed., 2010).

168. *Id.* at 96–97.

169. *Id.*

170. Ugo Mattei, *Three Patterns of Law: Taxonomy and Changes in the World's Legal Systems*, 45 AM. J. COMP. L. 5 (1997).

171. Taisu Zhang, *The Pragmatic Court: Reinterpreting the Supreme People's Court of China*, 25 COLUM. J. ASIAN L. 1, 4–5 (2012).

172. The phrase derived its origin from a speech by the then President Jintao Hu at a National Conference on Political-Legal Work convened by the CCP's central Political-Legal Committee. President Hu said: "In their work, the grand judges and grand procurators shall always regard as supreme the par-

merely describes the established dominance of the political system among the three systems, as the supremacy of the Party has always been placed in the front. But on the other hand, the three-supremacy reveals how the Chinese judiciary system responds delicately to the current environment with a strong Party control and strong economic performance. Indeed, the inclusion of the supremacy of the Constitution and law can only be deemed politically expedient within an environment with stringent political constraints. At the very least, the supremacy of laws has successfully been maintained and, more importantly, juxtaposed with the other two supremacies, thereby securing a niche for the legal system in the Party state.

The dominant political system may also contribute to special features in the lawmaking process. It is observed that legal development in China has more often than not been the product of CCP administrative policies.¹⁷³ Laws are introduced only when opportunities mature, such that it is usually the case that “econom[ic] necessity drove policy reform,” leading legislation to legitimize successful experiences and to further supplement the institutional predilection for the economic development.¹⁷⁴ For instance, foreign trade had been promoted in practice ever since the open door policy was introduced, whereas the Foreign Trade Law was only promulgated a decade later in 1994.¹⁷⁵

This approach, whereby policy leads legislation, is also apparent in the evolution of laws on SOEs. SOEs, originally known as State Run Enterprises (“SREs”), had long been deemed gov-

ty’s cause, the people’s interest and the constitution and laws.” This was further enhanced by a series of promotions within the judicial system by the then president of the Ministry of Justice. For a brief comment, see Jerome Cohen, *Jerome Cohen on the “Three Supremes,”* HARVARD L. BLOG (Oct. 23, 2008), <https://blogs.law.harvard.edu/guorui/2008/10/23/jerome-cohen-on-the-three-supremes>.

173. See Linda Yueh, *ENTERPRISING CHINA: BUSINESS, ECONOMIC, & LEGAL DEVELOPMENTS SINCE 1979*, at 12 (2011).

174. *Id.*

175. World Intellectual Property Organization [WIPO], WIPO Lex. No. CN124, available at <http://www.wipo.int/wipolex/en/details.jsp?id=6584> (last visited Nov. 18, 2013). Foreign Trade Law was first introduced in 1994 but amended in 2004.

ernment organs rather than independent legal persons.¹⁷⁶ In order to reform those inefficient SREs, the state introduced a series of administrative policies to enhance the autonomy of the SREs, policies which consummated in the Decision of the Central Committee of the Chinese Communist Party on Several Issues Concerning the Reform of the Economic System in 1984.¹⁷⁷ Even though productivity had generally improved among SREs, state subsidies still supported many inefficient SREs.¹⁷⁸ It is thus no wonder that the Enterprise Bankruptcy Law ("EBL") mainly targeting SREs was not introduced until 1986, two years after the policy was first explored in a north-eastern city.¹⁷⁹

176. See Liufang Fang, *China's Corporatization Experiment*, 5 DUKE J. COMP. & INT'L L. 149 (1995). For a summary on the history of SOE reform, see Yueh, *supra* note 173, at 102–03.

177. See Yueh, *supra* note 173, at 102–03.

178. Yiping Huang, Wing Thye Woo & Ron Duncan, *Understanding the Decline of China's State Sector*, 9 MOST: ECON. J. ON E. EUR. & THE SOVIET UNION 1, 5 (1999). Huang et al. observed that the initial efforts to promote autonomy of and introduce more initiatives of managers were largely ineffective by measuring the size of total factor productivity ("TFP") growth. In fact,

the total losses of industrial SOEs rose from 4.2 billion yuan in 1978 to 34.9 billion yuan in 1990 and 72.7 billion yuan in 1996; an astonishing annual growth rate of 17 percent between 1978 and 1996. It is widely estimated that, in the 1990s, about one third of SOEs made explicit losses and another one-third made implicit losses.

(citation omitted) *id.* at 5. Huang et al observed that "Direct subsidy to loss-making SOEs rose from 18.2 billion yuan (1.2 per cent of GNP) in 1988 to 84.4 billion yuan (2.4 percent of GNP)." *Id.*

179. This refers to the nationally well-known bankruptcy of Shenyang Anti-Explosion Equipment Factory in 1984. Article 1 of the law tells the importance of the law to the SRE reform:

This Law is devised to meet the need for development of the socialist planned commodity economy and economic system reform, to promote the operation of all-people owned enterprises, to strengthen the economic responsibility system and democratic administration of all-people-owned enterprises, to improve management, to enhance economic efficiency, and to protect the legal rights and interests of creditors and debtors.

For the law and brief comment, see Douglas G. Boshkoff & Yongxin Song, *China's New Bankruptcy Law: A Translation and Brief Introduction*, 61 AM. BANKR. L.J. 359, 359–62 (1987); see also Mark E. Monfort, *Reform of the*

The Contract Responsibility System, a supplementary measure to promote productivity, through which managers reached a contract with the state, was first experimented and then promoted nationwide by the enactment of the Provisional Regulations on Contracting Management System in SOEs in 1988.¹⁸⁰ The importance of all such efforts was to cultivate a common understanding that SOEs are separate legal persons with their own autonomy.¹⁸¹ With such efforts, the opportunity to introduce a law on SREs became mature. The Law on Industrial Enterprises Owned by the Whole People (“LIEOWP”) was then passed in 1988 despite the fact that SOEs, as the main organization form, had been in existence ever since the foundation of the country.¹⁸²

With experience accumulated in the development of the private economy and related foreign investment, the Company Law of 1993 further facilitated the corporatization of SOEs, through which most small and medium sized SOEs had been privatized.¹⁸³ By the time the SOE reform had gone through the phase of “Grasp the Big and Let the Small Go,” inefficient small and

State-Owned Enterprises and the Bankruptcy Law in the People's Republic of China, 22 OKLA. CITY U. L. REV. 1067, 1080–81 (1997).

180. By such a system, the CEO or leader of the SO, who was the legal representative of the SOEs, signed contracts with the government, the basic principle of which were stipulated in s5 of the Provisional Regulation, i.e., to “lock the minimum amount of profit for the SOEs to pay to the State,” and entitle SOEs “to keep the remaining profit, but [remain] liable for paying the fixed amount to the State even if [the] SOEs have not made satisfactory profit.” For a more detailed discussion, see Cindy Schipani & Junhai Liu, *Corporate Governance in China: Then and Now*, 2002 COLUM. BUS. L. REV. 1, 8–11 (2002).

181. See Yueh, *supra* note 173, at 102–03.

182. Section Two of the Law on Industrial Enterprises Owned by the Whole People reads: “The property of the enterprise shall be owned by the whole people (equivalent to the notation of ‘State’), and shall be operated and managed by the enterprise with the authorization of the State in line with the principle of the separation of ownership and managerial authority.” Zhonghua Remin Gongheguo Quanmin Suoyou Zhi Gongye Qiye Fa (中华人民共和国全民所有制工业企业法) [Law on Industrial Enterprises Owned by the Whole People] (promulgated by the Standing Comm. Nat’l People’s Cong., April 13, 1988, effective Aug. 1, 1988), ch. II, art. 2.

183. While Western scholars usually employ the word privatization, corporatization is used in China.

medium sized SOEs had already failed at the efficient use of assets and labor.¹⁸⁴ As a result, the narrow application of the EBL of 1986 became increasingly outdated.¹⁸⁵ The Bankruptcy Law was then revamped in 2006, reflecting not only the change of the attitude of the government towards the SOE reform but also the requirements of a developing private economy and more intensive foreign related investment.¹⁸⁶

The above examples show that policies, compared with laws, are good at applying the experimental approach and facilitating the learning process. However, a side effect of this first approach to administrative policy is that laws necessary for a free market economy may not be introduced easily. For instance, a well-defined property law has long been claimed as a precondition to economic development, yet the introduction of the Property Law was not possible until 2007, almost thirty years after the open door policy was introduced in 1978, due to the ideological constraints on the protection of private properties.¹⁸⁷ Also, as a key law in setting up a free market, the Anti-Trust

184. The policy was introduced in 1997 at the 15th Communist Party Congress, Naughton summarized succinctly: "In 'letting the small go,' policy-makers were giving local governments much greater authority to restructure their own firms and, in particular, to privatize or close down some of them [L]ocal government-run factories were not only much smaller than those of the central government, but also much more exposed to competitive pressures and consequently much less profitable. In fact, in the mid-1990s all of the state-owned small and medium enterprises put together were losing money." BARRY NAUGHTON, *THE CHINESE ECONOMY: TRANSITIONS AND GROWTH* 301–02 (2007). For empirical evidence of the policy, see Samuel Ho, Paul Bowles, & Xiaoyuan Dong, "Letting Go of the Small": *An Analysis of the Privatisation of Rural Enterprises in Jiangsu and Shandong*, 39 *J. DEV. STUD.* 1 (2003).

185. As the economy was still strictly a command economy from the central government and state-owned enterprises were the main organization form, the law emphasizes the goal of imposing responsibilities on persons responsible for business failure rather than the equitable and efficient distribution of assets. See Boshkoff & Song, *supra* note 179, at 361.

186. See Yueh, *supra* note 173, at 119–20. This also refers to the bankruptcy of Shenyang Anti-Explosive Equipment Factory in 1984.

187. Mo Zhang, *From Public to Private: The Newly Enacted Chinese Property Law and the Protection of Property Rights in China*, 5 *BERKELEY BUS. L.J.* 317, 323–37 (2008); see also Gerald P. O'Driscoll Jr. & Lee Hoskins, *Property Rights: The Key to Economic Development*, 482 *POL'Y ANALYSIS* 1 (2003).

Law (“ATL”)¹⁸⁸ was only introduced fourteen years after the introduction of the Unfair Competition Law. It is not to say that anti-trust issues had not been in existence when China first introduced the Unfair Competition Law, but instead that strong political resistance from the vested interest groups successfully postponed the introduction of the ATL, which aimed to achieve the anti-administrative monopoly among SOEs.¹⁸⁹ Consequently, despite the prioritization of economic goals, an inactive political system is still able to postpone the introduction of laws necessary for a free market economy.

Nevertheless, as the market economy develops further, intrusions of the political system into the functioning of the legal system, and the negative effects associated with such activity, may well be retreating. Indeed, when Peerenboom studied the implications of the strong role of the Party on the development of Chinese administrative law before China was admitted to the WTO, he observed that “[r]ather, the Party’s main relevance to administrative law lies in its ability to promote or obstruct further political and legal reforms that would strengthen the legal system, but could also lead to the demise of the Party or to a drastic reduction in its power.”¹⁹⁰

After the accession of China to the WTO, structural coupling with the international world further improved the development of the Chinese legal system.¹⁹¹ In order to perform its obliga-

188. Zhonghua Renmin Gongheguo Fan Longduan Fa (中华人民共和国反垄断法) [Anti-Monopoly Law of China] (promulgated by the Standing Comm. Nat’l People’s Cong., Aug. 30, 2007, effective Aug. 1, 2008) (China), available at <http://lawinfochina.com/display.aspx?id=6351&lib=law&SearchKeyword=anti-trust&SearchCKeyword=>.

189. While the local protectionism was not successfully curbed in the former UCL, the ATL, with a special target at anticompetitive (local) government actions, is at least on paper a powerful dose on (administrative) monopoly to secure a competitive socialist market economy on a historically state-controlled market. See Salil K. Mehra & Meng Yanbei, *Against Antitrust Functionalism: Reconsidering China’s Antimonopoly Law*, 49 VA. J. INT’L L. 379 (2009).

190. Randall Peerenboom, *Globalization, Path Dependency and the Limits of Law: Administrative Law Reform and Rule of Law in the People’s Republic of China*, 19 BERKELEY J. INT’L L. 161, 167 (2001).

191. See Julia Ya Qin, *Trade, Investment and Beyond: The Impact of WTO Accession on China’s Legal System*, 191 CHINA Q. 720, 724–37 (2007).

tions as a member of the WTO, both substantive and procedural administrative laws have already gone through a series of revisions.¹⁹² More importantly, the conception of due process and rule of law has increasingly been accepted in the administrative system.¹⁹³ In addition, the development of specialized markets, such as product factor markets, especially the financial markets, may dictate a stronger role of law due to stronger coupling of the national economy with the established institutional environment of the West.¹⁹⁴ For instance, to comply with the WTO rules, China set up the China Banking Regulatory Commission,

192. See Ying Songnian (应松年) & Wang Xixin (王锡锌), *WTO yu Zhongguo Xingzheng Fa Zhidu Gaige de Jige Guan-Jian Wenti (WTO 与中国行政法律制度改革的几个关键问题)* [WTO and Several Key Issues of China's Administrative Law Reform], *ZHONGGUO FAXUE* («中国法学») [CHINESE LEGAL SCIENCE] (2002) (China), available at http://en.cnki.com.cn/Article_en/CJFDTOTAL-ZGFX200201001.htm; see also Rongzhen Yang, *Research of China's Participation in the WTO Trade Policy Review Process* (Ind. Univ. Research Ctr. For Chinese Politics & Bus. Working Paper No.8, 2011), available at http://www.indiana.edu/~rccpb/Working_Paper/Yang%20Rongzhen%20RCCPB%208%20TPR%20PUB.pdf.

193. WTO significantly improved members' domestic administration by promoting such norms as transparency, participation, reason giving, and review. See Ljiljana Biulovic, *Selective Adaptation of WTO Transparency Norms and Local Practices in China and Japan*, 11 J. INT'L ECON. L. 803, 809 (2008) (quoted in Richard Stewart & Michelle Badin, *The World Trade Organization: Multiple Dimensions of Global Administrative Law*, 9 INT. J. CONST. L. 556, 572–73 (2011)).

194. A unique character accompanying the astonishing economic growth is the rather pessimistic development in the financial market. The economic development in China can mainly be attributed to the development of (international) trade. But the incompatible development in financial markets, especially the development of the securities market, may again remind us of the legal origin theories proffered by Rafael La Porta et al. See *supra* note 2. See also Thorsten Beck, Asli Demirguc-Kunt & Ross Levine, *Law and Finance: Why Does Legal Origin Matter?*, 31 J. COMP. ECON. 653 (2003). Beck et al. summarized that the current theories on why legal origin matters for financial development can be categorized into two groups, i.e., the political channel (starting by looking at the relationship between investors and the state and then at the implications on the development of property rights and financial markets), and the adaptability channel (the ability of the legal system to adapt to the increasing demands of financial development). According to Beck et al., the adaptability of a legal system to the evolving economic conditions matters more for the development of the financial market. See *id.* at 654–55.

the China Security Regulatory Commission, and the China Insurance Regulatory Commission, providing an institutional base for financial market reform in China, and by issuing detailed regulations, these regulatory authorities are better prepared for the reform of the Chinese capital market.¹⁹⁵

2. Adaptation on the Dual Track

For the past thirty years, one apparent characteristic of the development of the Chinese legal system was the existence of dual track systems, which made possible a trial-and-error approach. One example of the dual track exists in substantive laws regulating economic activities involving foreign parties and those for domestic participants. For instance, Economic Contract Law 1981 and Foreign Parties Related Economic Contract Law 1985 were only unified into the Unified Contract Law in 1999.¹⁹⁶ Also, the Joint Venture Law (“JVL”) introduced the company as an organizational form for the purpose of attracting foreign investment in 1979, whereas Chinese Company Law (“CCL”) was only introduced in 1993.¹⁹⁷ Detailed rules on the establishment and annual reviews of companies with foreign investment were also introduced so that the JVL could be under scrutiny.¹⁹⁸ The dual track in law conveniently drew a line be-

195. For example, the newly introduced Qualified Foreign Institutional Investors (“QFII”) regulations not only permit foreign investors to invest in Chinese securities markets but also help to improve the corporate governance of listed companies. See Weihua Wu, *Are Qualified Foreign Institutional Investors Real Investors or Speculators: Evidence from China* (May 10, 2011) (unpublished article) (on file with author), available at <http://ssrn.com/abstract=2056056>.

196. The Technology Transfer Contract Law was also unified into the Contract Law 1999. David W. Hill, *Recent Developments in Technology-Transfer Laws of China*, FINNEGAN (May 1, 2006), <http://www.finnegan.com/resources/articles/articlesdetail.aspx?news=091abd88-0fd4-4d20-81e2-c1ece8c3fc3b>.

197. *Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Fa* (中华人民共和国中外合资经营企业法) [Foreign Joint Venture Law] (promulgated by the Standing Comm. Nat'l People's Cong., July 1, 1979) (China); *Zhonghua Remin Gongheguo Zhuxi Ling* (中华人民共和国主席令) [Company Law] (promulgated by Standing Comm. Nat'l People's Cong., Dec. 29, 1993, amended Oct. 27, 2005, effective Jan. 1, 2006) (China).

198. See *Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Fa Shishi Tiaoli* (中华人民共和国中外合资经营企业法实施条例) [Regulations for

tween laws for domestic agents and those for overseas investors, and the experiences accumulated from foreign companies were later successfully transplanted to the CCL 1993.¹⁹⁹ Even though revisions of the CCL were made in 2005, special regulations on Joint Ventures as stipulated in the JVL still enjoy priority whenever there is a conflict between the JVL and the CCL 2005.²⁰⁰

Likewise, a similar dual track scheme can be found in arbitration regarding commercial disputes. In the past, the China International Economic and Trade Arbitration Commission and China Maritime Arbitration Commission were devised to deal with arbitration for disputes involving foreign parties, whereas the Economic Contracts Arbitration Commission with its domestic divisions controlled the domestic arbitration.²⁰¹ Considering the deficient court system, arbitration has long been preferred as an alternative to court proceedings.²⁰² Such delinea-

the Implementation of the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures] (promulgated by the St. Council, Sept. 20, 1983) (China), available at <http://english.mofcom.gov.cn/article/lawsdata/chineselaw/200301/20030100064563.shtml>.

199. See generally Linda Yueh, *Law in China's Transition* 13–15 (Int'l Soc'y for New Institutional Econ., Working Paper, 2007), available at www.isnie.org/assets/files/papers2007/yueh.pdf.

200. Chinese Company Law [C. CIV.], art. 218 (China), translated in CHINA: COMPANY LAWS AND REGULATIONS HANDBOOK (International Business Publications rev. ed. 2012). Article 218 of the CCL 2005 states that "The limited liability companies and joint stock limited companies invested by foreign investors shall be governed by this Law. Where there are otherwise different provisions in any law regarding foreign investment, such provisions shall prevail." *Id.*

201. See Shi Weisan, *Arbitration and Conciliation: Resolving Commercial Disputes in China*, 12 LOY. L.A. INT'L & COMP. L. REV. 93 (1989). A series of surveys during this period teach Chinese governors vivid lessons, ranging from the benefits of the separate legal personality of a company as an organizational form, to the autonomy of the manager to the internal governance of enterprises. See Yasheng Huang, *The Role of Foreign-Invested Enterprises in the Chinese Economy: An Institutional Foundation Approach*, in CHINA, THE UNITED STATES, AND THE GLOBAL ECONOMY 147 (Shuxun Chen & Charles Wolf, Jr. eds., 2001).

202. The dual track scheme was relaxed only quite recently, when both types of arbitration institutions were allowed to arbitrate both international and domestic cases.

tion between related domestic and foreign arbitration secures a niche for arbitration of international disputes, while at the same time requiring the maintenance of a separate domestic arbitration practice. Learning between tracks thus helps to improve domestic arbitration practices, and arbitration centers in China are now all allowed to docket international cases.²⁰³

Apart from the above foreign-domestic double track, China's dual track also exists in laws regulating the state owned sector and those on the private sector. It must be realized that the existence of a private economy was not recognized in law until 1988, almost ten years after the economic reform.²⁰⁴ The delineation was employed not only to explore the viability of the development of a private economic sector, but also to help the then loss-suffering SOEs through a difficult time by transfer-

203. Donald Clarke, Peter Murrell & Susan Whiting, *The Role of Law in China's Economic Development*, (2007), in LOREN BRANDT & THOMAS RAWSKI, CHINA'S GREAT ECONOMIC TRANSFORMATION 375, 389 (2007). The Court of Arbitration of China Chamber of International Commerce was established in 1956 and established branches in Shenzhen (1984) and Shanghai (1988). CHINA INT'L ECON. & TRADE ARBITRATION COMM'N, <http://www.cietac.org/index.cms> (last visited Dec. 20, 2013). The Arbitration Law was passed in 1994, according to which local arbitration centers sprout up at local levels. However, the law does not prescribe clearly whether these arbitration centers can accept cases involving foreign factors. A Notification to Clarify Several Issues relating to the Implementation of the Arbitration Law of the PRC was issued by the General Office of the State Council in June 1996, according to which arbitration centers at local levels can accept cases with foreign factors as long as the parties select arbitration as a way to settle their disputes. Guowuyuan Bangongting Guanyu Guanche Shishi Zhonghua Renmin Gongheguo Zhongcai Fa Xvyao Mingque de Jige Wenti de Tongzhi (国务院办公厅 关于贯彻实施中华人民共和国仲裁法需要明确的几个问题的通知) (1996), *available at* <http://www.people.com.cn/zixun/flfgk/item/dwjf/falv/9/9-2-1-09.html>.

204. The First Amendment to the Constitution of 1982 was made in the first Plenary Session of the 7th National People's Congress in 1988. M. Ulric Kilion, *China's Amended Constitution: Quest For Liberty and Independent Judicial Review*, 4 WASH. U. GLOB. STUD. REV. 43, 45 (2005). A new paragraph was attached to Article 11, which reads, "The State permits the private sector of the economy to exist and develop within the limits prescribed by law. The private sector of the economy is a complement to the socialist public economy. The State protects the lawful rights and interests of the private sector of the economy, and exercises guidance, supervision and control over the private sector of the economy." XIANFA art. 11, §1 (1988).

ring profits from the private sector and providing job opportunities for a large number of displaced employees of the SOEs at the beginning of the reform.²⁰⁵ As large-scale unemployment was successfully avoided, both the macroeconomic goals and social stability had been maintained, a key element that contributed to the efficacy of the gradual approach in China.²⁰⁶

In sum, the merit of the dual track system is that the co-existence of both the old and the new makes possible a guided structural coupling, which can easily be set up between systems under the two tracks. Such an approach not only helps to locate the merits of systems under each track but also facilitates the digestion of those merits between tracks, benefiting the search for an appropriate growth trajectory for the whole system. What cannot be downplayed in such a dual track system is the importance of the adaptive manager role of the government or regulatory authority, which acts as a valve switcher for the structural coupling and as the environment stabilizer so that the intended learning and digesting can become reality.

3. Adaptation in Fast Transition

Laws in a fast growing economy are usually introduced as political expediencies. One revealing example will be helpful here. For instance, prioritized economic goals of local governments led to serious concerns of weak protection for employees, and in order to address these concerns and pacify large-scale social unrest, the new Labor Contract Law ("LCL") was introduced at the beginning of 2008.²⁰⁷ Nevertheless, ever since the LCL was

205. See Gang, *supra* note 161, at 115.

206. See Yueh, *supra* note 173, at 10.

207. Before the introduction of Labour Contract Law in 2008, the Labour Law 1994 was the main reference. However, underpayment, or no payment of employees, or the fraudulent and manipulative conduct of employers was the norm. See Anita Chan, *Labor Standards and Human Rights: The Case of Chinese Workers under Market Socialism*, 20 HUM. RTS. Q. 886, 891–93 (1998). The introduction of the LCL 2008 seriously constrains illegal acts such as non-payment of wages in the private sector, especially for migrant workers, which was increasingly acute and courted criticism from different sectors of the society. See Sean Cooney, *Making Chinese Labour Law Work: The Prospects for Regulatory Innovation in the People's Republic of China*, 30 FORDHAM INT'L L.J. 1050, 1053–54 (2006). For a general but perceptive review

in consultation stages, employers have complained about the “overprotection” of employees.²⁰⁸ The increasing cost for labor protection has since been a serious concern for Small- and Medium-sized Enterprises (“SMEs”), which contribute the most to the employment agenda of the country but are the most hard-pressed to afford due protection to their employees.²⁰⁹

Indeed, creative reactions from the employers had immediate effects on employees.²¹⁰ Immediately before the law came into effect, employees were laid off across the country or were fired and re-employed through employment agencies at lower wages.²¹¹ Alternatively, employers may choose to relocate to other

of the LCL 2008, see Hilary Josephs, *Measuring Progress under China's Labor Law: Goals, Processes, Outcomes*, 30 COMP. LAB. L. & POL'Y J. 373 (2009).

208. In the consultation process, business organizations, and international organizations specifically, worked against the drafts of the LCL. See Sean Cooney, Sarah Biddulph, Li Kungang & Ying Zhu, *China's New Labour Contract Law: Responding to the Growing Complexity of Labour Relations in the PRC*, 30 UNIV. NEW S. WALES L.J. 788, 789 (2007). The increasing cost has been a major concern for numerous small private companies. See Caifeng Liu, *New Labor Law Makes Firms Cautious to Hire, Fire*, 4 CHINA ECONOMIST 126 (2009), available at www.ssrn.com/abstract=1544208.

209. For a comment on the Labour Contract Law on Foreign Invested Enterprises, see Monique Garcia, *China's Labour Law Evolution: Towards a New Frontier*, 16 ILSA J. INT'L & COMP. L. 235 (2009).

210. Haiyan Wang, Richard Appelbaum, Francesca Degiuli & Nelson Lichtenstein, *China's New Labour Contract Law: Is China Moving Towards Increased Power for Workers?*, 30 THIRD WORLD Q. 485, 492–93 (2009).

211. See Yu-Fu Chen & Michael Funke, *China's New Labour Contract Law: No Harm to Employment?*, 20 CHINA ECON. REV. 558, 560 n.10 (2009). See also, Yin Lily Zheng, *It's Not What Is on Paper, but What Is in Practice: China's New Labor Contract Law and the Enforcement Problem*, 8 WASH. U. GLOBAL STUD. L. REV. 595, 602–03, 603 n.52–54 (2009). Such practices can be observed in both domestic companies such as Huawei (offered termination of existing employment contracts to seven thousand employees) and foreign invested enterprises such as Carrefour (resigned labor contracts) and Wal-Mart (dismissed workers in 110 purchasing departments). Bin Wu & Yongniang Zheng, *A Long March to Improve Labour Standards in China: Chinese Debates on the New Labour Contract Law* 7 (Univ. of Nottingham China Policy Inst. Briefing Series Issue 39, 2009); Don Lee, *New Workers' Rights Thwarted in China*, L.A. TIMES (Dec. 27, 2007), <http://articles.latimes.com/2007/dec/27/business/fi-chinalabor27/2>; Jovita T. Wang, *Article 14 of China's New Labor Contract Law: Using Open-Term Contracts to Appropriately Balance Worker Protection and Employer Flexibility*, 18 PAC. RIM L. & POL. J. 433, 449 (2009).

areas with lower wage levels.²¹² Due to the increased labor costs associated with the LCL and the intense competition for limited employment opportunities, employees may have no choice but to accept lesser contractual terms, which defeats a major intended protection under the LCL.²¹³ Even worse, the law was promulgated just one year before the onset of the world financial crisis, such that SME employers that have long functioned in labor intensive export processing industries were further aggravated as a downturn in international markets is reorienting those SME exporters to seek an increasing share of the domestic market.²¹⁴

At the same time, employees are increasingly conscious of their legal rights.²¹⁵ Empirical data show that labor disputes

212. See Garcia, *supra* note 209, at 240–41, 248–49.

213. See *id.* at 248–50.

214. It is noted that the drastic shrinkage of demand for Chinese exports on the European and American markets (in combination with the then ongoing industrial restructuring within China) compelled more than 20 million rural migrants back to their hometown. See Gyorgy Sziraczki, Phu Huynh & Steven Kapsos, *The Global Economic Crisis: Labour Market Impacts and Policies for Recovery in Asia* 1–6 (Int'l Labour Org. Asia-Pacific Working Paper Series, 2009), available at http://www.ilo.org/wcmsp5/groups/public/—asia/—ro-bangkok/documents/publication/wcms_110095.pdf. For implications of the 2008 financial crisis on exports from China, see Qiuguang Hu & Hongying Li (胡求光与李洪英), *Jinrong Weiji dui Zhongguo Chukou Maoyi Yingxiang de Shizheng Fenxi* (金融危机对中国出口贸易影响的实证分析) [*Empirical Analysis on the Influence of the Financial Crisis to Trade of China*], 3 《国际贸易问题》 [J. INT'L TRADE] 3 (2010). Scholars also recommended that increasing demand on the domestic market may serve as a solution. In fact, Joseph Stiglitz identified the danger of export-led growth and recommended the development of a domestic market early in 2007 before the financial crisis. See Joseph Stiglitz, *China: Towards a New Model of Development*, 1 CHINA ECON. J. 33 (2008). For a general comment, see Fang Cai & Dewen Wang, *Employment Should Top Crisis Agenda*, POPULATION & LABOR ECON. RESEARCH INST., CHINESE ACAD. OF SOC. SCI, available at <http://iple.cass.cn/upload/2012/06/d20120604115932007.pdf> (last visited Jan. 7, 2014).

215. For a detailed study on the implications of the new Labor Contract Law on Chinese workers, see Mary Gallagher, John Giles, Albert Park & Meiyang Wang, *China's 2008 Labor Contract Law: Implementation and Implications for China's Workers* (World Bank, Policy Research Working Paper No. 6542, 2013) (noting that awareness of legal rights is increasing even among migrant workers).

have increasingly been brought to courts and arbitration tribunals, and that the number of cases with a plaintiff involving more than ten employees has also been on the upward trend ever since the promulgation of the LCL.²¹⁶ Employees may intentionally postpone signing the legally required employment contracts by dragging the negotiation process until the one-year period terminates.²¹⁷ Employees may also collectively threaten

216. For instance, Guangdong Courts filed nearly 160% more cases in the first six months of 2008, while the arbitration tribunal received 300% more labor disputes. For statistics, see *Laodong Zhengyi Duofa Diqu de Jiben Shuju* (劳动争议多发地区的基本数据) [Annual Statistics on Labour Dispute Cases], <http://www.labournet.com.cn/ldzy/> (last visited Sept. 13, 2013). For comments, see generally Jenny Chan, *Meaningful Progress or Illusory Reform? Analyzing China's Labor Contract Law*, 18 NEW LABOR FORUM 43 (2009); Edward Wong, *As China Aids Labor, Unrest Is Still Rising*, N.Y. TIMES, June 21, 2010, at A1, available at <http://www.nytimes.com/2010/06/21/world/asia/21chinalabor.html>.

217. Article 82 of the LCL reads:

If an employer fails to conclude a written labor contract with an employee after the lapse of more than one month but less than one year as of the day when it started using him, it shall pay to the worker his monthly wages at double amount.

If an employer fails, in violation of this Law, to conclude with an employee a labor contract without fixed term, it shall pay to the employee his monthly wage at double amount, starting from the date on which a labor contract without fixed term should have been concluded.

Labor Contract Law of the People's Republic of China, LEHMAN, LEE & XU, <http://www.lehmanlaw.com/resource-centre/laws-and-regulations/labor/labor-contract-law-of-the-peoples-republic-of-china.html> (last visited Jan. 20, 2014).

While it is true that it is usually employers that intentionally drag along the negotiation process and lead to the break-up of the negotiation process, employees may also intentionally take advantage of the law to compromise the interests of employers, especially SMEs. See Liang Da (梁达), *Jinfang Guyi bu Qian Laodong Hetong de Shuangbei Gongzi Zhuanjia* (谨防故意不签劳动合同的双倍工资专家) [Attention Shall Be Paid to "Double-Wage Specialists" Employees Who Intentionally Declined to Sign the Employment Contracts], 152 YIAN SHUOFA (《以案说法》) [LAW & CASES] 40 (2010). Xu Chen & Fei Liu (陈旭与刘菲), *Laodong Zhe Daode Fengxian yu Shuang Bai Gongzi Zhipei Zeren Paichu* (劳动者道德风险与双倍工资支配责任排除) [Moral Risks of Workers and the Avoidance of Duty to Pay Double-Wage], 24 PEOPLE'S JUDICATURE (CASES) (《案例研究》) 75 (2010). There is no clear stipulation on such issues in LCL. See Yefang Qian & Hongxia Zheng, *Shall Double-Wage Compensation Be Applied*

to bring their disputes to arbitration tribunals if there is no increase in wages, signaling social unrest and incremental pressure from local governments on the employer.²¹⁸

As a result, local governments have been struggling to strike the right balance between the implementation of the labor law and the strong initiative to pursue economic growth within a stable social environment.²¹⁹ Such a goal is not uncommon to a fast growing economy, which is keen on further economic growth whereas the success of growth can lead to hindrances in the form of an increase in the importance of social concerns.²²⁰ A decision, however, has to be made before potentially negative effects develop into catastrophes and shift the whole system to a different fitness landscape with unimaginable uncertainties. Indeed, the current alternative to China's growth is decelerated economic development with increasingly serious consideration of social concerns.²²¹ Hence, even though economic growth is still of importance in the current development agenda, the newly introduced draft of the ECL apparently disregards the

to Cases Where No Written Employment Contract Can Be Reached Due to Negotiation?, CHINA LABOR, 51 (2011); Hao Wu & Tianli Wen (吴昊与温天力), *Zhongguo Difang Zhengce Shiyan Shi Gaige de Youshi yu Juxianxing* (中国地方政策试验式改革的优势与局限性) [*The Merits and Demerits of Reform Through Local Experimentations*], 10 《社会科学战线》 [SOC. SCI. FRONT] 37 (2012); Zhansheng Gao, (高战胜), *Wei Qianding Shumian Laodong Hetong shi Laodongzhe erbei Gongzi Qingqiuquan de Shiyong Tiaojian Yanjiu* (未签订书面劳动合同时劳动者二倍工资请求权的适用条件研究) [*Study on the Conditions to Apply the Right to Claim Double-Wage in Cases of Failure to Sign Written Employment Contracts*], 12 L. SCI. MAG. (法学杂志) 154 (2012).

218. This may first initiate media attention and then pressure on governments. See Yin Lily Zheng, *supra* note 211, at 614.

219. See Cooney, *supra* note 207, at 1066.

220. See generally Garcia, *supra* note 209.

221. Hu Jintao, Chinese President and General Secretary of the Cent. Comm. of the Communist Party of China, *Rep. to the Eighteenth Nat'l Cong. of CPC, Part VII: Strengthening Social Development by Improving the People's Wellbeing and Making Innovations in Management* (Nov. 12, 2012), available at http://www.chinadaily.com.cn/language_tips/news/2012-11/19/content_15941774.htm.

negative concerns for economic growth and prioritizes the social concern of employees.²²²

B. The Relevance of Rule of Law

One evident observation to be made is that the Western idea of employing rule of law as a governance tool to constrain the supremacy of the government has long been a foreign concept to Chinese culture. According to Professor Orth, rule of law as a second feature was initially introduced to counterbalance the supremacy of the central government, which historically was the chief feature of political institutions of England.²²³ With separation of powers in place in the political system, rule of law is effectively employed in the West to place limitations on the different branches of government.

However, the absence of the separation of powers in the political system of China does not provide a suitable context for transplanting Western-style rule of law.²²⁴ As described earlier, the dominance of Confucianism over Legalism since the Han dynasty indicates that rule by man historically dominated over rule by law in China.²²⁵ While a strengthening of the rule of law system was advocated for upon the death of Mao Zedong, it was introduced with a strong communist ideological objective to

222. For comments referred to on the NPC official website, see *New Labour Law Means Better Image but at Higher Cost*, XINHUA NEWS AGENCY (Jan. 2, 2008) (China), available at http://www.npc.gov.cn/englishnpc/news/Legislation/2008-01/02/content_1387865.htm. The draft of the Amendment to the Labor Contract Law has been brought to the National Peoples' Congress Standing Committee for discussion on June 26, 2012. Improving the benefits for employees is one of the key issues for revision. See *China Amending Labor Law to Protect Contractors*, XINHUA NEWS AGENCY (June 27, 2012) (China), http://www.npc.gov.cn/englishnpc/news/Legislation/2012-06/27/content_1726582.htm.

223. At least at that time, the concept was not common to Western legal philosophy. See John Orth, *Exporting the Rule of Law*, 24 N.C.J. INT'L L. & COM. REG. 71 (1998).

224. This is also the reason why Professor Randall Peerenboom proffered the division of the thick and the thin rule of law. See PEERENBOOM, CHINA'S LONG MARCH TOWARD RULE OF LAW, *supra* note 1, at 3-6.

225. See Tan *supra* note 91.

serve party control.²²⁶ Moreover, this system was dismantled almost completely during the Cultural Revolution, and immediately after the collapse of the Gang of Four, when rule by law was introduced to legitimize the new leadership, maintain the social order, and enhance the control of the Party.²²⁷ The western conception of rule of law is thus merely an academic topic with no practical observance in China.

Besides, China remains cautious in pursuing the complete acceptance of Western-style rule of law after experiences accrued with foreign jurisdictions as a product of structural coupling. For instance, the experiences of geographically and culturally proximate Asian countries indicate that a dual track system with the coexistence of both a well-developed commercial law system and stringent constraints on civil and political rights is a much more achievable objective for developing China.²²⁸ Additionally, China continues to work on building its *sui generis* legal system within a socialist framework.²²⁹ Thus, it is not unfair to say that skepticism of rule of law informs Chinese culture.²³⁰

In sum, the configuration of the operational closure and the structural coupling of the Chinese legal system present a different picture from that of the West. For one thing, the operational closure of the Chinese legal system is enhanced by its

226. See ALBERT H.Y. CHEN, AN INTRODUCTION TO THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA 33–34 (rev. ed. 1998).

227. Carlos Wing-Hung Lo, *Socialist Legal Theory in Deng Xiaoping's China*, 11 COLUM. J. ASIAN L. 469, 475 (1997) (describing Deng's pragmatic search for a Chinese path with an objective "to free China from the constraints of both Soviet ideas and Mao's theory of the state and law" in Part B: Conceptions of Law under Deng Xiaoping).

228. See Fu & Peerenboom, *supra* note 167, at 110.

229. Bangguo Wu, the top legislator of China, in his work report of the Standing Committee of the National People's Congress delivered at the second plenary meeting of the first session of the 12th NPC at the Great Hall of the People in Beijing, capital of China, announced that "We will comprehensively advance law-based governance of the country, and enhance the important role that the rule of law plays in national governance and social management." *China's Top Legislator Vows to Push 'Rule of Law,' Keep Power in Check*, XINHUA NEWS AGENCY (Mar. 8, 2013), available at <http://english.people.com.cn/90785/8159917.html>.

230. See generally Pat Chew, *The Rule of Law: China's Skepticism and the Rule of People*, 20 OHIO ST. J. ON DISP. RESOL. 43 (2005).

long-established Confucian culture and the modern socialist ideology. For another, given the strong outward radiating effect of the Chinese political system, the independence of the Chinese legal system cannot be achieved alone. While the further development of the economic system does require a favorable co-evolution of the legal system, such positive effects are still within the ambit of the socialist political system. Given that “changes in formal law matter where prevailing cultural norms say that formal law matters,”²³¹ a foolhardy transplantation of new laws or the audacious unconditional acceptance of rule of law without consideration of the underlying legal tradition and the institutional arrangements may just do a disservice.²³²

IV. COMPATIBLE SYSTEMS TO ACHIEVE SUSTAINABLE GROWTH

A. *The Role of Law*

For the purposes of economic development, laws function as both positive and negative constraints. As positive constraints, laws and regulations facilitate economic development by introducing favorable laws and regulations, by providing suitable dispute resolution, and by training more legal professionals. For example, at the very beginning of Chinese economic reform, the focus of legal reform was on the laws of attracting foreign investment, which provide more certainty than those on other domestic legal relationships.²³³ In addition, the Constitution was amended in 1988 to accommodate new economic development, such as when changes to Article 10 relaxed a long restricted land policy and spurred foreign investment activities in China by permitting that “the land-use right may be assigned in accordance with the provisions of the law.”²³⁴ Though rudi-

231. Rosa Brooks, *The New Imperialism: Violence, Norms, and the Rule of Law*, 101 MICH. L. REV. 2275, 2322 (2002).

232. Katharina Pistor & Philip A. Wellons, THE ROLE OF LAW AND LEGAL INSTITUTIONS IN ASIAN ECONOMIC DEVELOPMENT 283–84 (1999).

233. See Yuangzheng Cao, *World Economic Restructuring and China's Economic Transformation*, in CHINA, THE UNITED STATES, AND THE GLOBAL ECONOMY 25 (Shuxun Chen & Charles Wolf, Jr. eds., 2001).

234. *Amendment to the Constitution of the People's Republic of China*, THE NATIONAL PEOPLE'S REPUBLIC OF CHINA (April 12, 1988), http://www.npc.gov.cn/englishnpc/Constitution/node_2829.htm.

mentary in comparison with Western law, these efforts, in combination with the political environment, served the purpose of economic development effectively.

Alternatively, laws and regulations may restrict economic growth. For instance, the introduction of Law on Environment Protection²³⁵ and the mandatory disclosure requirement of environmental issues for publicly listed companies²³⁶ not only reflect the incremental serious concern for environmental issues but also function as negative constraints on the single-minded pursuance of economic growth without due consideration of environmental responsibility. In combination with tax preferential treatments, the introduction of such laws may significantly direct fresh investment to cleaner industries.²³⁷

235. For a more detailed description of laws relevant to environmental cases, Environment Protection Law (Art 41) and General Principles of Civil Law (Art 124) are relevant sources. *Zhonghua Renmin Gongheguo Huanjing Baohu Fa* (中华人民共和国环境保护法) [Environmental Protection Law of the People's Republic of China] (promulgated by Standing Comm. Nat'l People's Cong., Dec. 26, 1987, effective Dec. 26, 1987) art. 41; *Zhonghua Renmin Gongheguo Minfa Tongze* (中华人民共和国民法通则) [General Principles of the Civil Law of China] (promulgated by Nat'l People's Cong., Apr. 14, 1986, effective Jan. 1, 1987) art. 124. The newly introduced Tort Law 2009 (effective as of July 2010) provides further facilitation and more specific and powerful legal sources for environmental cases (Chapter 8 of the China Tort Law). *Zhonghua Renmin Gongheguo Qinquan Zeren Fa* (中华人民共和国侵权责任法) [Tort Law of China] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 26, 2009, effective July 1, 2010) ch. 8. Cases can be initiated not only in civil law courts, but in administrative and criminal courts as well.

236. Companies going through IPO and refinancing on the public capital market must be reviewed and approved by the provincial Environmental Protection Bureaus. *See* *Guanyu dui Shenqing Shangshi de Qiye he Shenqing zai Rongzi de Shangshi Qiye Jinxing Huanjing Baohu Hecha de Tongzhi* (关于对申请上市的企业和申请再融资的上市企业进行环境保护核查的通知) [Measures on Review and Approval of Environmental Protection of Enterprises Applying for IPO and Refinancing for Listed Companies] (issued by the Ministry of Env'tl. Protection of China, June 16, 2003, effective June 16, 2003). *See also* Press Release, Ministry of Env'tl. Protection of the People's Republic of China, MEP Calls for Public Comments on Guidelines for Disclosure of Environmental Information of Listed Companies (Sept. 14, 2010), *available at* http://english.mep.gov.cn/News_service/news_release/201009/t20100926_194964.htm.

237. Tax preferential treatments can be located in Art. 36. Press Release, Ministry of Fin. of the People's Republic of China, Notice on Preferential Treatments for Software Enterprises, by the Ministry of Finance and the Na-

Laws also play an important role in curbing the race to the bottom arising from deregulation. Unregulated competition among local governments in searching for global maximums may not be suitable for a fast growing economy. This is not only due to the complexity of a natural evolution process but also because of the spillover of costs across local boundaries. For instance, short-sighted focus on local economies after the decentralization in 1988 only led local governments to fragment the national market into closed, stagnant patches.²³⁸ The Unfair Competition Law was introduced in 1993 with a specific purpose of curbing the then notorious regionalism within the country.²³⁹

B. The Supplementary Nomenklatura System

The political system and the legal system may supplement each other in function. For instance, Hoff and Stiglitz argued that the lack of a serious political demand for the rule of law contributes to the postponed establishment of rule of law in post-communist societies.²⁴⁰ According to this thesis, resource

tional Tax Bureau (Feb. 22, 2008) available at <http://www.customs.gov.au/webdata/resources/files/282GovernmentofChina-ResponsetoSecondSupplementalQuestionnaire-Attachment200.pdf>.

238. Shen et al., *supra* note 145, at 31.

239. Article 30 of the Anti-Unfair Competition Law (1993) states that

If the government or its departments violate Article 7 of this Law to force the others to purchase the commodities from the pointed manager, limit the others make a fair competition, or limit commodities to transfer between regions, the senior government shall order to correct these mistakes; If the fact is serious, the same level government organ or the senior government organ shall administratively punish the person who bear the direct responsibility.

Zhonghua Renmin Gongheguo Fan Bu Zhengdang Jingzheng Fa (中华人民共和国反不正当竞争法) [Anti-Unfair Competition Law of China] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 2, 1993, effective Dec. 1, 1993) art. 30 (China), available at <http://www.lawinfochina.com/display.aspx?lib=law&id=648&CGid=>.

240. Karla Hoff & Joseph Stiglitz, *After the Big Bang? Obstacles to the Emergence of the Rule of Law in Post-Communist Societies*, 94 AM. ECON. REV. 753 (2004). The power to control can be both positive and negative. Positive in the sense of wealth accumulation and negative in the sense of stripping the accumulated assets of others.

controllers make both economic and political choices to safeguard their own earned interests.²⁴¹ By using their political power to strip the assets of others, resource controllers can achieve resource accumulation similar to that which would be possible by making positive economic decisions under a sound system of rule of law.²⁴² The political institution favorable to those vested interest groups may thus resist the introduction of rule of law into the country.

The implication of this understanding is that a strong political institution at least supplements, if not replaces, the rule of law in accumulating and distributing resources.²⁴³ The applicability of such a thesis can similarly be observed in China, where the Nomenklatura scheme has long been employed in practice as a tool to redress the deficiency of both the legal system and the political system.²⁴⁴ For instance, when Clark and others studied the weak role of formal legal institutions in China, especially a weak scheme on property rights, they found the importance of non-legal institutions to be strong.²⁴⁵ In order to attract investment and retain investors, local governments compete in providing preferential arrangements.²⁴⁶ In fact, due to the authority given to judges, and the extent of their discretion in ruling,²⁴⁷ the enforcement of court decisions in a socialist polit-

241. *Id.*

242. *Id.*

243. Jan Smits & Michael Faure, *Does Law Matter, An Introduction* 6–9 (Maastricht European Private Law Inst., Working Paper No. 2011/35, Nov. 2011), available at www.ssrn.com/abstract=1950335.

244. Apart from Professor Clarke, discussed below, other scholars also identify the important role of the Nomenklatura scheme in achieving political stability and economic growth. See Hon, *supra* note 126.

245. Clarke, et al., *supra* note 203. But notice that Clarke et al. also point out the stronger than expected role of law in transactions: “in the area of transactions of goods and services, we present new data that show that the legal system is more important than might be assumed, given the enormous emphasis that personal and social relationships have played in the literature discussing markets in China.” *Id.* at 376.

246. For instance, more preferential tax treatment may be offered by the local governments to attract foreign investment.

247. The triple discretion in courts identified by Professor Woo is just one example of how the legal system coevolves with its environment. The first discretion is discretion on facts, discretion which is conducive to locate substantive solutions to conflicts between parties. Discretion on facts however is

ical legal system is “neither a neutral, technical issue, nor an automatic consequence of law,” and both under- and over-enforcement is possible according to the policy demands.²⁴⁸ In other words, the deficiency of the judiciary system may largely be supplemented by the existing Nomenklatura scheme.

In parallel, when Wang and others compared the regional variations of Foreign Direct Investment (“FDI”) within China, they found that good economic fundamentals, or “factors contributing to a higher rate of return on investment,” may play a more important role in attracting new investment.²⁴⁹ They also found that government officials with long-term career visions and concern of self-reputation also help to attract FDI in a weak legal system.²⁵⁰ In fact, a political and administrative environment favorable to overseas investors is seen as especially desirable when it is accompanied by a weak legal system.²⁵¹ Similarly, Professor Zheng also observed that “[a]t the practical level, the protection of capital and property rights at various levels in the Chinese government surpassed the rule of law.”²⁵²

The efficacy of employing the existing Nomenklatura scheme as a way to achieve the intended reform objectives shall not be underestimated. Once the economic performance of the area administered by the local officials was included among the criteria of performance evaluation, thereby making a difference to

limited for the increasing consciousness of law and technology development. The second discretion is self-interested discretion, by which personal relations and non-legal factors are considered and balanced. This is what happens in *renqing* cases or *guanxi* cases. The third discretion is ideological discretion, where politically sensitive cases will be readily decided by following ideological principles such as the four fundamental principles (as stipulated in Constitution 1982: “adherence to the socialist road, to the people’s democratic dictatorship, to the leadership of the Communist Party, to Marxist-Leninist-Mao Zedong Thought”). The last discretion has the least freedom to change. See Margaret Woo, *Law and Discretion in Contemporary Chinese Courts*, in THE LIMITS OF THE RULE OF LAW IN CHINA 163, 163, 165–72 (Karen Turner, James Feinerman & Kent Guy eds., 2000).

248. See Castellucci, *supra* note 163, at 59.

249. Xiaozu Wang, Lixin Xu & Tian Zhu, *Foreign Direct Investment under Weak Rule of Law: Theory and Evidence from China* 9 (World Bank Dev. Research Grp., Working Paper No. 5790, 2011).

250. *Id.* at 21.

251. *Id.* at 17–22.

252. See Zheng, *supra* note 144, at 6.

the career path of local officials, the lack of rule of law may provide chances for both over- and under-protection in comparison with the protection provided in formal law. In fact, the initial single-minded pursuit of economic prosperity may lead the government to intentionally support formal enforcement via arbitration or to threaten potential government sanctions.²⁵³ Clark and others argue that the “political structure itself has served as an alternative to the formal legal system in providing a reasonable degree of security to certain non-state investors at the local level.”²⁵⁴

Later, when the early fervor for economic growth cooled down to include more social concerns, the Nomenklatura system was again employed to achieve the intended reform objective. For instance, even though environmental protection law has long been introduced, its enforcement is still far from satisfactory.²⁵⁵ Personal interests, either in terms of finance, political promotion, or even bribery, all lead to its ineffective enforcement at local levels.²⁵⁶ Nevertheless, when environmental protection is included among the political performance assessment formula, serious consideration of environmental issues by local governments may become a reality.²⁵⁷

Hence, within an institutional environment with a leading political system dominated by a single party, the Nomenklatura scheme supported by the Party has been effectively employed to

253. Ronald J. Gilson & Curtis J. Milhaupt, *Economically Benevolent Dictators: Lessons for Developing Democracies*, 59 AM. J. COMP. L. 227 (2011).

254. Clarke et al., *supra* note 203, at 400.

255. See William Alford & Yuanyuan Shen, *Limits of the Law in Addressing China's Environmental Dilemma*, 16 STAN. ENVTL. L.J. 125 (1997); Robert Percival, *The Challenge of Chinese Environmental Law* (U. of Md. Sch. of Law Legal Studies Research Paper No. 2008-40, 2008), available at <http://ssrn.com/abstract=1277290>; Jason E. Kelley, *Seeking Justice for Pollution Victims in China: Why China Should Amend the Tort Liability Law to Allow Punitive Damages in Environmental Tort Cases*, 35 SEATTLE U.L. REV. 527 (2011).

256. See Patricia Ross McCubbin, *China and Climate Change: Domestic Environmental Needs, Differentiated International Responsibilities, and Rule of Law Weaknesses*, 3 ENERGY & ENVTL. L. & POL'Y J. 200, 228–29 (2008).

257. See *Environmental Law “First Amendment”: Strengthening the Government Act*, CHINESE NAT'L PEOPLE'S CONG. (Oct. 16, 2012), http://www.npc.gov.cn/npc/zgrdzz/2012-10/16/content_1739473.htm.

supplement the deficient legal system for the purpose of economic development. If it is true, according to the theory of Hoff and Stiglitz, that the political elites in developing countries, in comparison with their counterparts in developed countries, have more institutional specific investment and benefit more from the established institution,²⁵⁸ it will be hard for developing countries to establish a new institution so as to counteract those vested interests. A more feasible choice is to take advantage of the existing institutional arrangements. Such a realization also suggests that the role of the legal system in a country prioritizing economic development is linked more to the flexibility of the legal system to adapt to the local institution than to the attributes of the legal system *per se*.²⁵⁹ In other words, the compatibility of the function of the different systems within an institutional environment may be more important than the quality of any individual system.

C. The Importance of the Strong Central Control

The coexistence of a strong central control and the well-established Nomenklatura system facilitates an efficient learning process for the whole system. For one thing, deregulation to local governments provides bountiful opportunities for maximum regulation “tinkering” at local levels whereas the strong central control intentionally encourages or cossets such creativity.²⁶⁰ For instance, the three main experiments at local levels that contributed to past economic success, *i.e.*, the house-hold responsibility system from Fengyang in 1978, the Special Economic Zone in Guangdong and other coastal areas, and the SOE reforms in Sichuan and Hunan, all secured vigorous support from the central government in their initial stages.²⁶¹

For another, the hierarchical structure under strong central control provides an adaptable institutional framework for the

258. Gilson & Milhaupt, *supra* note 253, at 238.

259. Katharina Pistor, Yoram Keinan, Jan Kleinheisterkamp & Mark D. West, *Innovation in Corporate Law*, 31 J. COMP. ECON. 676, 678 (2003); Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, *Economic Development, Legality, and the Transplant Effect*, 47 EUR. ECON. REV. 165, 167 (2003).

260. See Heilmann, *supra* note 157, at 454–57.

261. See Cai & Treisman, *supra* note 156, at 514–19.

experiences accumulated within experimental localities to be transmitted to other regions upon success. Given the detrimental implications brought by the unregulated free competition between provinces, structural coupling between local governments is thus of special importance to achieve sustainable economic growth.²⁶² In practice, effective structural coupling can be achieved in several ways. First, by introducing administrative measures or issuing party orders, the results of local experiments can be shared across the nation.²⁶³ Second, coupling can be enhanced by personnel movement of government officials between municipalities.²⁶⁴ Former experience accumulated by government officials either at other provinces or at the central government may also be employed across boundaries. Third, by intentionally introducing laws, limitations on inter-provincial structural coupling may at least be constrained.²⁶⁵

The ultimate effect is that local diversity may calculatedly be promoted, but within the constraints or the grid established by the central government. Viewed from that perspective, policymakers at higher levels may accordingly function as gatekeepers and advocators for useful, locally generated innovations.²⁶⁶ Thus, the combination of inter-provincial competition and strong central control provides an appropriate institution for China to achieve the adaptive efficiency of the whole system.

262. Sebastian Heilmann, *Policy Experimentation in China's Economic Rise*, 43 *STUD. COMP. INT'L DEV.* 1 (2008).

263. *Id.*

264. This is can be attributed to the Nomenklatura system, through which the central government may dispatch and move personnel according to the plan of the national economy as a whole. For the role of Nomenklatura system in Chinese economic development, see Hongbin Li & Li-an Zhou, *Political Turnover and Economic Performance: The Incentive Role of Personnel Control in China*, 89 *J. PUB. ECON.* 1743 (2004).

265. Zhonghua Renmin Gongheguo Fan Bu Zhengdang Jingzheng Fa (中华人民共和国反不正当竞争法) [Anti-Unfair Competition Law of China] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 2, 1993, effective Dec. 1, 1993) art. 30 (China), available at <http://www.lawinfochina.com/display.aspx?lib=law&id=648&CGid=>; Anti-monopoly Law (promulgated by Presidential Order No. 15, effective Aug. 1, 2008) (China), available at http://www.wipo.int/wipolex/en/text.jsp?file_id=182375.

266. See Heilmann, *supra* note 157, at 457.

For this, Professor Heilmann's remark is pertinent: "It is precisely the dialectical interplay between dispersed local initiative and central policy making—maximum tinkering under the shadow of hierarchy—that has made China's economic governance so adaptive and innovative from 1978 to 2008."²⁶⁷

In consequence, distortions from a free market economy may be partially redressed by a strong political (administrative) system in practice.²⁶⁸ Such understanding indicates that a totally "laissez-faire" market economy in combination with a well-established rule of law may not be compatible with the socialist economy in China. In fact, structural coupling with the economic systems in other countries also shows that the role of government intervention is necessary.²⁶⁹ The intermittent financial and/or economic crises at least provide evidence that a free market economy pursued in the West is not without its detriments.²⁷⁰ To the Chinese government, the invisible market hand must be balanced with the indispensable visible hand of the government. The fate of a national economy is thus dependent not on whether the invisible hand of the market is strong enough to function freely but on how the two hands in cooperation can achieve the objective.

In essence, the key issue here is that the decision-making process is no longer an *ex ante* "process of setting rigid standards based on comprehensive rational planning," but an ongoing process of "experimentation using continuous monitoring, as-

267. *Id.* at 458.

268. Robert W. Fogel, *Why China Is Likely to Achieve Its Growth Objectives* 14 (Nat'l Bureau of Econ. Research, Working Paper No. 12122, 2006), available at <http://www.nber.org/papers/w12122>.

269. See Gilson & Milhaupt, *supra* note 253.

270. Some objectives of financial market regulation include determining to what extent law can help control financial chaos, and why the protection of the financial system itself should also be included, other than for the maximization of economic efficiency, see Steven Schwarcz, *Controlling Financial Chaos: The Power and Limits of Law*, 2012 WIS. L. REV., 815 (2012). To what extent shall the law penetrate economic life, see Bernadette Meyler, *Economic Emergency and the Rule of Law* (Cornell Law Sch. Legal Studies Research Paper Series No. 06-045 2006), available at <http://ssrn.com/abstract=944618>.

essment, and recalibration.”²⁷¹ Viewed from this perspective, the central government or the party plays an important role of manager in guiding the adaptive walk.

D. Dynamic Compatibility to Achieve Sustainable Growth

A review of economic growth in China shows that the Chinese government intentionally takes advantage of existing conditions for the purpose of achieving institutional flexibility. The deficient legal system had partially been redressed by the political and administrative system. As stated earlier in this article, the “meta-rights—access or rights to property rights” under the unique Chinese political and administrative system clearly counterbalanced the lack of protection for property rights under the property law.²⁷² In other words, a deficient legal system, an indicator of low institutional quality, does not necessarily indicate a lack of institutional flexibility for the whole system. For instance, the continuing local experiments were only possible without legal constraints.²⁷³ At the beginning of reform, policy experimentation at local levels could be carried out as long as a report was approved by the central government that the intended experiments were in compliance with the spirit of the central policy.²⁷⁴ Thus, the deficient legal institution may have enhanced institutional flexibility by promoting competition among local governments, a key contributor to the economic growth in China.

The legal system is just one important component of the *meta* governance, the aim of which is to achieve the sustainable growth of whole system.²⁷⁵ The past experience of China at least

271. Even though Ruhl is describing the recent development in American court management, the quotation is applicable to the trial-and-error style adaptive walk. See Ruhl, *supra* note 20, at 428.

272. This thus corresponds to the argument of de Soto, who argues that what matters in the economic development of the United States is not “property rights per se but meta-rights—access or rights to property rights.” Davis, *supra* note 75, at 308.

273. Hao Wu & Tianli Wen, *supra* note 217, at 37.

274. *Id.*

275. See Jianxing Yu & Ziyang He, *The Tension Between Governance and State-Building*, 16 J. CHINESE POL. SCI. 1 (2011). The current focus on governance study shows that both the anarchy of exchange as in the market mechanism and the hierarchical administrative structure as in a firm or a

showed that the compatibility among systems were more important than the quality of any one within the environment. Still, the compatibility itself is due to the co-evolution of subsystems within the system and that of the systems constituting the environment of the system. For instance, as the Chinese market becomes more integrated with the rest of the world, we observe incremental pressures on China to adapt its administrative system to international practices, as evidenced by China's need to reform, if not reshuffle, its administrative system of government in order to meet the requirements for accession to the WTO.²⁷⁶ As the domestic economy further develops, the State Council even claimed at the end of 2012 that the government shall withdraw itself from matters in which either citizens or the market are capable of self-regulating, and prohibit pre-imposed administrative review for items which can be reviewed *ex post* or through other administrative measures.²⁷⁷ While it is still a slogan at this stage, the pronouncement of such principles indicates that the government has been managing to adapt the system to the development of the market economy.

state may overshadow the importance of governance, a concept which should jump out of the traditional constraints of both the free market and the hierarchical style. Rather, governance emphasizes self-organization, a horizontal network and partnership, and “refers to mechanisms and strategies of co-ordination in the face of complex reciprocal interdependence among operationally autonomous actors, organizations, and functional systems.” *Id.* at 3. Moreover, the current governance study “indicates that a one-track approach favoring one over the other is inadequate to guide or explain the practice of governance today.” *Id.* But the authors leave open the question of how China can transition from an authoritarian government to the governance they define in the article.

276. Donald Clarke, *China's Legal System and the WTO: Prospects for Compliance*, 2 WASH. U. GLOB. STUD. L. REV. 97 (2003); Donald C. Clarke, *China: Creating a Legal System for a Market Economy* 12–13 (George Wash. Univ. Law Sch. Pub. Law & Legal Theory Working Paper No. 396, 2007), available at www.ssrn.com/abstract=1097587.

277. Guowuyuan Guanyu Diliupi Quxiao he Tiaozheng Xingzheng Shenpi Xiangmu de Jueding (国务院关于第六批取消和调整行政审批项目的决定) [Decision by the State Council to Revoke and Adjust Projects under Administrative Approval (the Sixth Batch)], (promulgated by the St. Council, Oct. 10, 2012) (China), available at http://www.gov.cn/zwgk/2012-10/10/content_2240096.htm.

However, one set configuration of compatible subsystems is only suitable for a given fitness growth mode, which is captured by one set of attractors and attractor basins. Once a new growth mode is introduced, the whole system will escape from the capture of the existing attractors and attractor basins and a new configuration suitable for the new growth mode will be required. Recent evidence shows that China is moving on a new growth mode, according to which a moderate growth rate will be pursued with a focus on developing a consumption-led growth mode and improving social welfare.²⁷⁸ Such a shift indicates that the initial compatibility among and between the political (administrative) system, the economic system, and the legal system, which are suitable to single-minded economic growth, may need to be changed. In consequence, as the market economy further develops, the legal system may become more autonomous and the configuration of the autopoiesis of the legal system may change accordingly. Still, it is noteworthy that no less emphasis should be imposed on comprehensive reform—a mindset suitable to achieve the adaptive efficiency of the whole system.²⁷⁹

CONCLUSION

The pursuance of a comprehensive reform package *per se* reveals that the Chinese government has long been following a systems view of the reform process. The above discussion reveals that it is the compatibility among the systems and the supplementary roles played by the other systems that partly redress the deficiency of the Chinese legal system and may accordingly provide a better explanation for the persisting economic development in China. This is not a single-direction simplistic linear determination but a networked non-linear coevolution with a strong sensitivity to the initial conditions of the systems in concern. The current economic success within the existing environment may thus persist, rather than collapse, on the condition that adaptable coevolution among the sub-systems can be successfully achieved. In other words, the compatibility of a system with the other systems in its environment may be

278. Yiping Huang, *China's New Growth Model*, E. ASIA FORUM (Apr. 14, 2013), <http://www.eastasiaforum.org/2013/04/14/chinas-new-growth-model>.

279. See Hao Wu & Tianli Wen, *supra note* 217, at 44.

more important than the quality of any individual system in concern.

Alternatively, Chinese development is not a result of a well-designed plan but an adaptive management process—a continuing recursive process of learning from field experience and using that information to guide further development.²⁸⁰ Due to the fast speed of transition, unexpected effects are the norm but are overseen by China's strong central control. On the whole, the Chinese government largely functions as an effective adaptive manager.

It is worth noting that the evolution of the market economy in the West is a natural evolutionary development process whereas the development of the market economy in China is an artificial short cut. If the gradual adaptation process is long enough to accommodate the Western-style evolution process, a more pro-Western style rule of law could be expected. However, the fact remains that a span of thirty years may be too short a period to achieve that purpose. Conversely, the recent successful economic experience of China may reinforce the development path of those sticky elements of the existing institution. If, however, the sticky political system becomes more incompatible with the other systems, the widely commended economic feat will soon yield unexpected catastrophes, a result the government will try its best to avoid.

280. In a word, Chinese “development must be a process of learning, selective adaptation, and innovation.” Justin Yifu Lin & Yan Wang, *China's Integration with the World: Development as a Process of Learning and Industrial Upgrading* 4 (World Bank Policy Research Working Paper No. 4799, 2008).