

**CHINESE SOCIALISM: AN ITERATIVE PERSPECTIVE
OF THE LEGAL FRAMEWORK
OF MARKET ECONOMIES OF THE PEOPLE'S REPUBLIC OF CHINA**

by

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ABSTRACT

This dissertation suggests that “socialism with Chinese characteristics” or “Chinese socialism” is an evolving and adaptable, rather than transitory and conflicting, ideology. I emphasize the iterative and evolutionary characteristics of the ideology, which occurs not only between economic and legal institutions, but also between social and political ones. I also stress the effect of global institution in this iterative evolution.

The iterative evolution denotes an interplay of ideological and practical aspects of Chinese socialism and represents a sequential institutional development of modern Chinese reforms. Among them, two institutional changes are noteworthy, namely property rights and market economy reforms. Using capital and land markets as examples, I show that ‘market’, as an institution that aims to delineate property rights, has flourished ongoing developments of property rights of capital and land markets, albeit in different manners respectively, in China. The case study of capital and land market demonstrates practical aspects of Chinese reforms including pragmatic, self-improvement, open, stability, and efficacy ideas.

I further argue that property rights reform is an impetus to the rule of law, whereas efficacy and stability mandates are conducive to open, yet controlled, society. This dissertation is otherwise devoted to providing a normative view on the long run evolution of Chinese socialism. I conclude that while Chinese reform appears lacking in a grand design that can articulate all of its content at the outset, an open policy and the interplay of socialism and local practicality will in the long run evolve towards a rule of law based open and controlled society in the PRC.

Further, as Chinese pragmatics, open culture, self improvement, stability, and efficacy are external mandates, which need be asserted by political leaders and policy makers of the PRC, political instability, ruling legitimacy, social instability, human right and civil liberty conflicts are all obstacles to the continuity and sustainability of the contemporary reforms. This dissertation suggests further study of the iterative process to address parallel developments of institutional reforms in political, social and legal areas.

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CHAPTER 1 OVERVIEW

1.1 Background

The ideology of socialism played an influential role in the past economic reforms of the modern era of socialist China. At one stage, under the leadership of Mao Zedong and Liu Shaoqi, economic reform of the 1950s and 1960s was heavily influenced by an ideology dominated by the Marxist-Leninist-Maoism path. The economic reform was characteristic of a socialist command economy where reform policy was typically centralized, planned and controlled.¹ At another stage, under the leadership of Deng Xiaoping, economic reform of the 1980s and 1990s was predominantly guided by a novel ideology commonly referred to as 'socialism with Chinese characteristics'. During the latter period, economic reform was characteristic of a 'socialist market economy' where reform policy was typically experimental, incremental and evolutionary.²

Economic reforms in these periods achieved mixed results with successes and failures. In particular, the latest reform, which commenced from 1978 until now has achieved astounding successes. Chinese economy has been growing at a pace that consistently surpasses the

¹See generally Yang, Dennis T. China's Agricultural Crisis and Famine of 1959-1961: A Survey and Comparison to Soviet Famines (2008) 50, no. 1 *Comparative Economic Studies* 1-29; see also Peng, Xizhe (彭希哲) Demographic Consequences of the Great Leap Forward in China's Provinces (1987) 13, no. 4 *Population and Development Review* 639-70

² See generally Goldman, Merle and Roderick MacFarquhar (ed) *The Paradox of China's Post Mao Reforms* Cambridge, Harvard University Press 1999; see also Fewsmith, Joseph *Dilemmas of Reform in China* New York, M.E. Sharpe 1994; see also Shirk, Susan L. *Political Logic of Economic Reform in China* Berkeley, University of California Press 1993; Perry, Elizabeth J. and Christine Wong *The Political Economy of Reform in Post-Mao China* Cambridge, Council on East Asian Studies 1985

Western economies, averaging about 10% per annum in GDP term, over the period.³ China has also achieved advancements in the fields of science, technology and aeronautics as a result of the economic reform. But, the success of the economic reform measured in aggregate term is misconceived for two reasons. Firstly, China's average living standard resembles the level of many poor countries of the world when measured on per capita basis. Secondly, reform in non-economic sectors such as legal and political sectors has had little progress, despite the successes in economic sectors. For these reasons, the focus of economic reform's analytics should not be confined to the inquiry of the economic reform. Rather, such inquiry should consider at least two more important aspects. One aspect is concerned with the economic reform's contribution to the improvement of average (rather than aggregate) living standards of Chinese population. Another aspect is concerned with the economic reform's influence on the reforms of non-economic sectors in China. This dissertation is mainly concerned with the latter.

1.2 Inquiries

Notwithstanding the successes of the contemporary economic reform of the PRC, some scholars suggest that the reform was in fact not a pre-conceived grand strategy at the outset.⁴ Moreover, when the novel concept of a socialist market economy was introduced in the early stages of the reform, many observers were skeptical about such an ah-hoc idea and wondered

³ USA Today, 2007-10-25

⁴ See Putterman, Louis. 'China's Encounter with Market Socialism: Approaching Managed Capitalism by Indirect Means' in Kornai, Janos and Yingyi Qian (ed) *Market and Socialism: In light of the Experiences of China and Vietnam* New York, Palgrave Macmillan 2009

whether such a concept would be sustainable, meaning whether the socialist market economy would be able to maintain its conceived form and substance over the long run.⁵

Such views believed that the novel concept of socialist market economy was not compatible with the traditional Marxian-Leninist-Maoist theory, since socialism was understood to be a political and economic system characterized by central planning and public ownership. Market and private ownership recognized by the socialist market economy would be inconsistent with these concepts.

As proven by history, the above views are flawed because they implicitly equate Chinese socialism with Marxian-Leninist-Maoist thoughts, and ignore the diversity of opinions about socialism. More importantly, these views fail to account for the dynamic relation between the ideology of socialism and the practicality of Chinese characteristics. In this dissertation, I contend that socialism is an evolving concept that is subject to interpretations, and Chinese socialism, representing one particular interpretation of socialism, is also an evolving concept that is differentiable with traditional Marxian concepts, and is a manifestation of the socialism by Chinese pragmatics.

That said, it still remains unclear whether the notion of market and private ownership is at least in theory compatible with such an evolving concept, and if so, what are the norms that constantly inform the evolution? In order to explore these questions, I inquire into the

⁵ See Hart-Landsberg, M. and Burkett, P. *China and Socialism: Market Reforms and Class Struggle*, New York, Monthly Review Press 2005; Also, see Buster, G. "The transition to capitalism", online magazine, IV355 December 2003, available from: <http://www.internationalviewpoint.org/spip.php?article117> as at 20 January 2012; and Huang, Yasheng "Just how capitalist is China?", MIT Sloan School Working Paper 4699-08, available from: http://papers.ssrn.com/sol3/pip_journal.cfm?pip_jrnl=285948 as at 20 January 2012;

normative content of Chinese socialism, particularly in relation to the question concerning the relationships between the ideology of Chinese socialism, the practicality of Chinese characteristics, and the socialist notion of market economy and individual property rights.

In order to address the above questions, the inquiries cannot be confined only to the study of economic and legal reform policies, but must also encompass their influences on the socialist ideology itself and norms that exert such influences. As such, the case study of the legal reform of Chinese capital markets and land markets involve a study of the Chinese interpretation of socialism, and vice versa.

Formulated as such, some important questions naturally arise. For instance, if the ideology is evolving, what then is the essence of the Chinese ideology? What is a socialist market economy? How will a socialist market economy distinguish itself from the Chinese version of socialism? More importantly, in the context of legal reform of capital markets and land markets of the PRC, what are the normative forces driving these reforms? What are the relationships of these forces with the broader forces that shape other socialist institutions of the PRC?

Specifically, how will market reform shape future development of socialism in China? And, in what way does market economy and individual property rights reform shape legal and political institutions in China? Similarly, how will other Western concepts of market economy including rule of law and open culture shape future development of socialism of the PRC? Are these concepts compatible with the ideology, notwithstanding its evolving nature? Will the ideology evolve toward an equilibrium state in the long run, given the premise that the ideology is in theory an adaptable concept? Last, but not least, what in essence is Chinese socialism?

These inquiries though multi-faceted transcends into one single theoretical as well as practical purpose. That is, through the study of the experience of the legal reform of capital and land markets of the PRC and the understanding of the ideological reform of Chinese socialism, this dissertation asserts a normative framework considered to be essential to the understanding of Chinese socialism while at the same time attempts to draw an insight on the inherent risks that may suffocate the evolution of the ideology from moving toward its ultimate goals.

1.3 Methodology

The methodology for the conduct of the above inquiries aims to satisfy three criteria. Firstly, it is required to answer the very basic question of adaptability. The reason is that, as this dissertation is concerned with the long-term development of the ideology, it is necessary to be able to discern with the transient concept of Chinese socialism and establish at the outset the thesis that the ideology is adaptable to new conditions over the long run. Based on this basic premise of adaptability, the inquiry into the convergence questions, as well as the relationships among the norms that lead to such convergence, will only then be meaningful.

Secondly, the methodology is required to draw upon historical data so that propositions concerning the practicality of local characteristics can be tested and validated. In particular, institutional changes that demonstrate sharp tension between capitalist concepts and socialist values are candidates of such historical accounts. In this regard, the methodology is designed to draw on historical experiences of market economy, private ownership, and individual property rights of modern China. The institutions of capital and land markets of the PRC serve as case examples for such study.

Thirdly, the methodology is required to develop a normative framework so that the questions concerning the long run evolution of Chinese socialism can be analyzed. The normative framework is required because any postulation about an ideology from its past into the future must necessarily be normative. A normative perspective is needed to address the “what ought to be” question and to explain institutional changes and the relations among these institutional changes over the long run.

Premised on the above criteria, the methodology of the dissertation consists of three separate but related discourses. The first discourse is an institutional framework of the Chinese socialist model, which articulates not only the Chinese ideology of socialism but also the Chinese characteristics that shape the evolution and adaptation of the ideology over the long run. The second discourse is a historical analysis of the legal reforms of market economies of the PRC, which aims to augment the first discourse by identifying the practicality of the Chinese characteristics. The third discourse is a normative model of the ideology of Chinese socialism, which aims to draw inferences from the evolution and adaptation of the Chinese ideology in the long run.

1.4 Thesis

Correspondingly, the thesis of this dissertation can be stated as three basic concepts. The first is that socialism is an evolving and adaptable concept.

I argue that it is evolving because the ideology of socialism with Chinese characteristics is shaped by the constituent institutions, which in turn are shaped by economic reform. As a result, as economic reform evolves so does the socialist ideology. It is adaptable because the

notion of Chinese socialism, as represented by its socialist economy, socialist legal system and socialist democracy, can be advanced from the traditional Marxian-Leninist-Mao thoughts such that it becomes compatible with the modern concepts of market, private ownership, pluralist interests, rule of law, and civil society.

The second concept is concerned with the continuing question of how socialism evolves and adapts to China. Here, two preliminary formulations are required. Primarily, at the core of Chinese socialism is a socialist commitment to create an egalitarian society, but one that lacks a pre-conceived design as to how such an egalitarian rhetoric is to be achieved. Secondly, Chinese political economy is broadly divided into three constituent socialist institutions: the economic, legal, and political institution. Based on these formulations, I argue that each institution is individually changed on its own as well as by the interplays with another institution. Such interplay is characterized by a normative and iterative process, guided simultaneously by the ideology of socialism and the practicality of local characteristics. The iterative relation between the ideology and the practicality explain how an institution is shaped by its own change as well as by the feedback of such change from other institutions. The iterative process, together with the institutional framework of the PRC, form a theoretical framework that can explain not only how domestic institutions are shaped by domestic and foreign institutions alike, but also how these institutions can shape the ideology of Chinese socialism.

The second concept therefore perceives Chinese socialism as neither entirely ideological nor entirely pragmatic, but is rather both ideological and pragmatic at the same time. Further, by way of case studies, I argue that the Chinese ideology is predominantly characterized by

traditional socialist values of public ownership and state intervention, whereas the Chinese practicality is characterized by local pragmatics, self-improvement culture, open policy, efficacy and stability goals.

The third concept, built on the above two, is a normative model of the institutional framework of Chinese socialism, which suggests that the legal reform of property rights will lead to the rule of law, and socialist goals of stability and efficiency will lead to an open yet controlled society in the long run. In other words, by formulating Chinese socialism as both ideology and pragmatic, it is conceivable that the Chinese political economy will eventually converge toward a rule of law based open and controlled society in the long run.

The corollary of the above, which is equally important, is that the obstacles to the long run convergence of the rule of law based open and controlled society includes all of the situations which potentially undermine proper functioning of the evolution and adaptation process, such as political instability, ruling legitimacy, legal tensions in human rights and civil liberties, as well as social instability.

In conclusion, this dissertation postulates insights that can be drawn from the theoretical analysis of the ideology of socialism and the historical study of the practicality of local characteristics of capital and land market reforms of the PRC, as well as the normative model of the equilibrium state over the long run. This dissertation also highlights the obstacles of political instability, ruling legitimacy, social instability, human right and civil liberty contentions as risks that will undermine, and may even suffocate, the iterative process of ideological reform. In this regard, openness as a local culture derived from the open door policy of economic

reform is critical as it is a catalyst to bring about political reform, social reform and further legal reforms to overcome the obstacles and mitigate the associated risks.

1.5 Terms of Reference

1.5.1 Scope

This dissertation is an inquiry of the concepts of Chinese socialism as well as the relations between Chinese socialism and its constituent institutions. The inquiry is both theoretical and historical. The theoretical analysis examines Chinese socialism by way of an interpretation of socialism that comprises of an iterative, evolutionary, and adaptable institutional framework. The historical study, which aims to augment the theoretical analysis, is conducted by way of case studies of legal development of market economies of the PRC.

The inquiry also includes a normative model, which explains the equilibrium state of Chinese socialism in the long run. It is pointed out, however, that the inquiry makes no attempt to relate Chinese reforms to those in other socialist countries, even though it attempts to compare socialism with capitalism in relation to the idea of an ideology spectrum.

1.5.2 Definition

Before I conduct the inquiry, I shall provide at the outset a brief introduction of the key concepts that I will refer to in this dissertation, as follows.

a) Socialism

What is socialism? This question arises because 'socialism' carries with it a diversity of opinions, and encompasses concepts such as political structure, ownership, coordination system, and ideology. In this dissertation, this term means, at a macro level, a political economy which aspires to the creation of an egalitarian society, but does not embody specific extent to which inequality can be eradicated or the means by which change can be effected,⁶ and at a micro level, a diversity of interpretations of the socialist concepts underpinning the political economy, such as state control, central planning, etc. In this latter regard, a political economy is considered to be 'socialist' if, and only if, it meets at least one of the socialist criteria, namely political structure mainly controlled by the state, ownership predominantly structured by public ownership, coordination mechanism heavily influenced by central planning, and ideology principally characterized by egalitarian rhetoric.⁷

It is noteworthy that, in practice, socialism is denoted by a political economy, which encompasses particular orientations of the above categorization. For example, Marx's concept of socialism is one orientation of the political structure, Walrasian-Lange concept of socialism is another orientation of public ownership, and Chinese concept of socialism is yet another orientation of state intervention and public ownership.

b) Pragmatism and Chinese Pragmatics

Here, instead of asking the question, what is pragmatism, which runs the risk of elevating theory over practice, the question is instead posed in a suitably pragmatic way (i.e. those

⁶ Ibid., p.3-4

⁷ See Kornai, Janos 'Socialism and the Market: Conceptual Clarification' in Kornai, Janos and Yingyi Qian (ed) *Market and Socialism: In light of the Experiences of China and Vietnam* New York, Palgrave Macmillan 2009

concerns that will help to identify the kind of things that a pragmatist is liable to assert, to be interested in, and to write about). In this regard, 'pragmatism' represents the breakup of cultural and religious authority, the turn away from any simple or stable definition of truth, the shift from totalizing systems and unified narratives to a more fragmented plurality of perspectives,⁸ and 'pragmatism' represents an emphasis on practical concern.⁹

The Chinese articulation of pragmatism is the metaphor "crossing the river by feeling the stones", which originally entered into Chinese political discourse in the late twentieth century through Deng Xiaoping's conception of Chinese economic reform of 1978. Put differently, the Chinese interpretation of pragmatism is essentially a local doctrine that does not believe in uniform solutions for every situation, makes little distinction between theory and practice, is willing to innovate and experiment to achieve practical results, and aspires to be gradual, incremental, and compartmental. In this dissertation, for the avoidance of confusion of semantics, Chinese interpretation of pragmatism is referred to as 'Chinese pragmatics', wherever appropriate.

c) Self-Improvement

This term is mainly used in the context of the iterative process of economic, legal, socio-political reforms of modern China. In such context, it refers to the reformists' aspiration that Chinese reform strives to correct its deficiencies at any point in time, and seeks improvement on each successive iteration of the reform process. In this dissertation, this aspiration, which underpins

⁸ Dickstein, Morris The Revival of Pragmatism: New Essays on Social Through, Law, and Culture, Durham NC, Duke University Press, 1998

⁹ Malachowski, Alan The New Pragmatism, Acumen Publishing Limited 2010, 18

the iterative reform process, is known as self-improvement mandate or culture. The reform, which attempts to improve upon itself by successive iterative steps, is called a self-improving process.

d) Chinese socialism

This term or concept is the crux of this dissertation. Hence, the normative meaning of this term or concept should be conceived at a broad context based on the following chapters.

Literally, Chinese socialism is taken to mean socialism with Chinese characteristics. Normatively, it means a political epistemology, comprising of the ideology of socialism and the practicality of local doctrines, which collectively determines whether a particular claim confronting a Chinese institution is to be afforded with certain institutional respect.¹⁰

Ideologically, Chinese socialism is characterized by state-centered political and ownership systems. Practically, Chinese socialism is characterized by local pragmatics, open policy, self-improvement mandate, and stability and efficiency goals. Chinese socialism is also a manifestation of the iterative relation between the ideology of socialism and the practicality of the local doctrines. Chinese socialism is essentially both ideological and pragmatic at the same time. It is ideological because it is hinged upon the traditional values of socialism, which is rooted to the commitment of egalitarian society. It is pragmatic because it is willing to innovate and experiment beyond the rim of the traditional values of socialism.

e) Openness

¹⁰Dowdle, Michael Of 'socialism' and 'socialist legal transformations in China and Vietnam, in Gillespie, John and Pip Nicholson (eds) *Asian Socialism and Legal Change: The Dynamics of Vietnam and Chinese Reform* Asia Pacific Press, The Australian National University 2005, 24

The term, 'openness', is used in three different, but related contexts in this dissertation. Firstly, it refers to an open door policy, which was originally advocated as a goal for Chinese economic reform and which prompted the opening up of Chinese economy to international trade and technology transfer with foreign countries in the latest economic reforms. Secondly, it refers to an open culture, which derives its content from a self consciousness of one's own fallibility and which implies an aspiration to expose local condition to an international worldview. Thirdly, it refers to an open society, in which a state keeps no secrets from itself in the public sense, and a non-authoritarian society-at-large is trusted with the knowledge of all.

The three references of the concept of openness are in fact inter-related. An open door policy helps to promote an open culture, and an open culture tends to promote an open society. If one accepts that the Chinese open door policy is irreversible, then it is conceivable that an open culture will gradually be persuaded as a preference in the local culture and pre-disposed in the ideology of Chinese socialism. Further, once an open culture becomes intrinsic to Chinese socialism, it is conceivable that an open society that aspires to the ideas of a non-authoritarian society-at-large will ultimately evolve in the long run.

f) Rule of Law

The concept of rule of law refers to the notion that a society at large, inclusive of individuals, the state, and all levels of local governments, are all to be treated equally before the law. This formulation, though appears to carry with it a universal meaning, implicitly means that the implementation of rule of law must necessarily carry with it certain political morality.

This dissertation adopts the argument that a socialist rule of law can be different from capitalist rule of law. A state-centered socialist rule of law defined by a socialist form of economy will emphasize stability, collective rights over individual rights, subsistence as the basic right rather than civil and political rights, while civic-centered democratic rule of law defined by a capitalist form of economy will emphasize individualism, liberalism, and human rights.

1.6 Road Map

This dissertation is organized into six chapters. Chapter one is an overview that outlines the background, inquiries, methodology, theory, terms of reference, and a roadmap to the other chapters. Chapter two is a discourse on socialism in general and Chinese socialism in particular. It explains the thesis that Chinese socialism is an evolving and adaptable ideology. In the chapter, an institutional approach is applied to study and understand the normative characteristics of Chinese socialism. It conceptualizes China's political economy as an institutional framework, which can be advanced to encompass new concepts of market economy, rule of law, and social democracy. Additionally, chapter two is also a discourse on the iterative theory. It shows that institutional change occurs in an iterative manner in China. Each institution is shaped by its own policy change as well as by the feedback of its own change from other institutions. Each step of the process represents an improvement of the previous iteration. Furthermore, in the global order, such institutional change is increasingly bi-directional whereby Chinese institutions are susceptible to global influences as much as global institutions are susceptible to Chinese influences. The iterative theory suggests that China's ideology evolves as its socialist institutions are reformed. The theory also suggests that China's

ideology not only evolves but also adapts as these institutions are reformed and advanced. As an institution is comprised of rules and methods, which determine whether or not particular claims are to be treated with institutional respect, Chinese socialism will continue to evolve and adapt with relevancy over the long run. Chapter three and four are case studies and a discourse on the practicality of local characteristics of Chinese socialism. It aims to identify what the local characteristics are, and how these characteristics will shape the ideology of Chinese socialism. The case studies are a discourse on the legal reforms of capital and land markets of the PRC. By application of the iterative theory and institutional approach, these chapters review that the local characteristics are pragmatics, self improvement, stability and efficiency. Chapter five is a discourse on the normative model of Chinese socialism. It melds together the theoretical framework of socialism and the practicality of Chinese characteristics, to explain the evolution and adaptation of Chinese socialism over the long run. The chapter examines the normative characteristics of the market economy and applies them to the Chinese socialist context. It identifies the fundamental norms that are, in essence, underpinning the socialist reforms of the PRC. In particular, it suggests that the legal reform of property rights will lead to the rule of law, while market reform of efficiency and stability will lead to open and controlled-based society. Finally, chapter six concludes the dissertation with a summary of the preceding chapters. It identifies the obstacles that may potentially suffocate the iterative process of reform and suggests further research on the application of the iterative theory to the labour market reform and other non-economic reforms, including political social and legal reforms.

CHAPTER 2 THEORETICAL FRAMEWORK OF CHINESE SOCIALISM

This chapter will develop the first concept of the thesis, namely that Chinese socialism is an adaptable and evolving concept, and both ideological and pragmatic. Further, an iterative process characterizes the dynamic relation between the ideological and pragmatic aspects of Chinese socialism. In the context of economic reform, this concept means that Chinese socialism is shaped by evolution and adaptation of capitalist ideas to socialist China. That is, the thesis suggests that Chinese socialism, as an evolving concept and with capitalist and socialist values embedded, is not a transient societal form but is instead an adaptable form of socialist ideology.

The theoretical framework for the above thesis consists of three perspectives, namely ideological, institutional, and iterative. The ideological perspective of socialism aims to conceive socialism as a permanent, rather than transient, class of ideologies situated along the spectrum, and that socialism carries with it a diversity of interpretations, which correspond to different orientations of the socialist ideology along the spectrum. Chinese interpretation of socialism is yet one of the interpretations along the spectrum, which is characterized by state intervention and public ownership.

The institutional perspective aims to conceive socialism, based on local characteristics of Chinese institutions, comprised of socialist market economy, socialist legal regime, and socialist democracy, as evolving and adaptable to new conditions prompted by Chinese reforms, which

is guided by traditional socialist values as well as Chinese pragmatics. The thesis of adaptability is particularly important because it provides a theoretical basis on which Chinese socialism – past, present and future – can be studied. Here, issues such as what is the essence of Chinese socialism, how does it evolve over times, and where will it evolve into in the long run, can be discussed.

The iterative perspective aims to conceive socialism as an illustrative process of dialogue between ideology and institutions. Guided by the ideology of socialism and the practicality of local characteristics, Chinese economic reform can be depicted as interplays of local movement of Chinese socialist institutions and global movement of socialist and capitalist ideologies. These movements shape the norms of local institutions in an iterative manner. This model is similar to other models which conceive Chinese reform of local institutions as being selectively and adaptively influenced by local and global movements, but it also contrasts with other models in that it conceives the process as an iterative process, including the evolution of global institutions as also being iteratively shaped. The iterative process is bi-directional in the sense that each institution can affect other institutions and can also be affected by these other institutions. In this model, global institutions are a particular instance of the iterative process. That is, local institutions are affected by global institutions as much as global institutions can be shaped by local forces. The iterative model does not presume superiority of either socialist or capitalist concepts. Rather, it conceives the interplays between socialist and capitalist values as an iterative evolutionary process, which strives to resolve the tensions among them.

2.1 Socialism

Broadly speaking, socialism is a political economy, which aspires to the creation of an egalitarian society, but does not embody specific extent to which inequality can be eradicated or the means by which change can be effected.¹¹ It carries a diversity of interpretations with it, and encompasses a bundle of socialist concepts such as state control, central planning, public ownership, and egalitarian rhetoric.¹²

Alternatively, socialism can also be perceived as an ideology situated along a capitalist-communist ideology spectrum. As such, socialism can be understood as a diversity of interpretations along the spectrum relative to capitalism and communism. Hence, relatively speaking, the starting point for the understanding of a socialist ideology spectrum is capitalist and communism ideas.

2.1.1 Socialism as Ideology Spectrum

Here, capitalism is said to exist wherever property is an object of trade and utilized by individuals for profit-making enterprise in a market economy.¹³ Accordingly, the basic ingredients of capitalism include at the minimum two concepts: namely a 'capitalist site' that includes the notion of a person, firm, industry, or economy functioning as an individual actor of a capitalistic system, and a 'capitalist practice' that includes the notion of an exploitation of labour or distribution of surplus value functioning as an profit-making ideology of a capitalist

¹¹ Ibid., p.3-4

¹² See Kornai, Janos 'Socialism and the Market: Conceptual Clarification' in Kornai, Janos and Yingyi Qian (ed) *Market and Socialism: In light of the Experiences of China and Vietnam* New York, Palgrave Macmillan 2009

¹³ Weber, Max *The Protestant Ethic and the Spirit of Capitalism: Talcott Parsons translation interpretations* Translated by Talcott Parsons Interpretations New York, W.W. Norton & Co 2009

system. As both concepts, capitalist site and capitalist practice, changes and evolves with time, so does capitalism.¹⁴ That is to say, capitalism is not a unique and deterministic concept, nor is it a stable and readily identifiable system. Rather, it is a notion that covers an extremely wide range of diverse economic activities. These activities are organized into a political economy whose institutional conditions include private ownership and non-state decision-making.¹⁵ In this sense, a market system that entails a private sector is a typical form of capitalism.

Notably, in theory, the building blocks of capitalism are usually expressed in perfect prescription. However, in practice, such institutions rarely exist in perfect form. Instead, they are an imperfect manifestation of their respective forms embedded with political morality adopted and implemented by the state. For example, the perfect form of private ownership is the notion of property right as a legal regime where upon private ownership is recognized, protected and enforced. However, from daily experience, the robustness of such legal regime is susceptible to defects when measured against such criteria as expropriation risk, risk of repudiation of contracts by government, rule of law, quality of bureaucracy and corruption in the government, etc.¹⁶ In another example, the perfect form of non-state decision-making is the notion of an economic arrangement in which economic decision-making power is shifted from the state to the society at large. However, perfect non-state decision-making processes are susceptible to defects and do not exist in practice. Such imperfection may be expressed

¹⁴Gibson-Graham, J.K. *The End of Capitalism* Oxford, Blackwell 1996

¹⁵Hamilton, Gary G. (ed) *Cosmopolitan Capitalists: Hong Kong and the Chinese diaspora at the dawn of the 20th century* Seattle, University of Washington Press 1999, pp.1-13

¹⁶Keefer P. and Knack, S. "Polarization, Politics and Property Rights: Links between Inequality and Growth" in *The World Bank Report*. Washington D.C. 2004, 14. Also, the International Country Risk Guide (ICRG) produces five indicators that specifically evaluate the credibility and predictability of property and contractual rights in a large number of countries.

and measured by the degree of privatization in terms of the fraction of productive means owned by the individuals. Although capitalism is comprised of more ingredients than just private ownership and non-state decision-making, the above discussion serves to illustrate two points (i.e. capitalism is an evolving concept and exists only in imperfect forms). The perfect form of capitalism merely serves as a reference point from which other imperfect forms of capitalism as well as other forms of ideologies can be measured.

As shown, socialism can be distinguished from pure forms of capitalism, and for that matter, communism, although both capitalism and communism do not exist in perfect forms in reality. Capitalism in its pure form is an ideology that aspires to be a laissez-faire free market system, which strives to distribute and manage limited resources in the most efficient way and for the maximum utility among individualistic capitalist sites. Conversely, communism in its purest form is an ideology that aspires to a classless society, which advocates equal benefits and opportunities. Therefore, by conceiving the perfect forms of capitalism and communism as two opposing ends of the ideology spectrum, socialism can be understood as an ideology in between which has an inclination to aspire to the ultimate ideal of communal values on the extreme right post, but may also encompass capitalist values from the extreme left post. A socialist system is closer to the communist side when it is embedded with more communal values, whereas a socialist system is closer to the capitalist side when it has embodied more capitalistic values. For instance, a socialist system which embraces public ownership and state planning falls into the former category whereas a socialist system which embodies private property rights and market determinism belongs to the latter category. Note that a socialist system is to be distinguished from imperfect capitalism to the extent that a socialist system

does not necessarily subscribe to capitalist values of private ownership and non-state decision-making, whereas imperfect capitalist systems often contain varying levels of private ownership and non-state decision-making. Nonetheless, a socialist system and an imperfect capitalist system are both situated along the ideology spectrum between pure capitalism and pure communism.

It is also noteworthy that while few would argue, for example, that Western welfare states are no longer capitalist because they have abandoned Adam Smith's *laissez faire* prescriptions, yet many may assert that socialist states are no longer socialist because mixed-market reforms have overtaken planned economies.¹⁷ To avoid this pitfall, I propose that a 'socialist' criterion shall be adopted as a benchmark, such that a system is described as 'socialist' or 'capitalist', depending if any of the criteria is met. For example, a political system is said to be 'socialist' if, and only if, it meets one or more of the socialist criteria of political structure, public ownership, central planning, or egalitarian rhetoric.

Now, by conceiving socialism as an ideology spectrum, different interpretations of socialism can then be conceived. In particular, Chinese socialism can be understood as one of the interpretations situated along this socialist ideology spectrum, provided that its political system, ownership structure, coordination mechanism, ideology are predominantly state controlled, publicly owned, centrally planned, or egalitarian oriented.

¹⁷ Gillespie, John and Pip Nicholson The Diversity and Dynamism of Legal Change in Socialist China and Vietnam in Gillespie, John and Pip Nicholson (eds) *Asian Socialism & Legal Change: The Dynamics of Vietnamese and Chinese Reform Asia* ANU E Press and Asia Pacific Press, The Australian National University, 2005, 2

2.1.2 Interpretations of Socialism

The significance of the above formulation of an ideology spectrum is that socialism is neither transient nor static. Rather, it represents a class of ideologies that aspire to capitalist and socialist values, provided that such capitalist and socialist values can coexist in any one particular orientation along the socialist ideology spectrum. In particular, 'socialism' can be broadly interpreted as to include any variant that embodies both capitalist and socialist values, as long as the variant satisfies one or more of the socialist criteria mentioned earlier.

Kornai, in his book *The Socialist System: The Political Economy of Communism*, identified four possible forms or interpretations of socialism: namely the Marx's concept of socialism, the Lange-Walrasian concept of socialism, the Leninist-Maoist concept of socialism, and the social democratic concept of socialism.¹⁸ These four interpretations represent four socialist orientations of political system, ownership, coordination mechanism and ideology. Kornai reckoned that these interpretations are not exhaustive but nevertheless serve as a clarification of the concept of the ideology of socialism, particularly in relation to its comparison with China's experience.¹⁹

Kornai's first interpretation is a Marxian formulation of socialism. This interpretation of socialism has no clear design of a political system and does not appreciate the concept of "bourgeois democracy", but rather advocates the concept of "dictatorship of the proletariat" as

¹⁸ See Kornai, Janos *The Socialist System: The Political Economy of Communism* Princeton, Princeton University Press 1992

¹⁹ See Kornai, Janos 'Socialism and the Market: Conceptual Clarification' in Kornai, Janos and Yingyi Qian (ed) *Market and Socialism: In light of the Experiences of China and Vietnam* New York, Palgrave Macmillan 2009, 22

the required steps to advance a socialist system to the full-fledged communist system.²⁰ This Marxian conception believes that the world has to be changed to public ownership because the capitalist class exploited the proletariat through the capitalist's ownership of the productive assets, which is incompatible with the concept of private ownership.²¹ Further, this Marxian conception advocates conscious and reasonable allocation of production forces or of labour or of time spent on labour. This is compatible with central planning and incompatible with the market, the latter of which is perceived as the contrast between capitalism and socialism.²² This Marxian conception recognizes the important role of ideology, but does not claim Marxism as an ideology and does not suggest socialism as a new ideology.

Kornai's second interpretation of socialism is an Oscar Lange's interpretation of socialism,²³ which is based on the Walrasian framework of economics. In this interpretation, socialism means public ownership and nothing else.²⁴ This interpretation is clearly distinguishable from the Marxian view in that it advocates public ownership as both the necessary and sufficient condition for calling a system "socialist". Lange-Walrasian's conception is not concerned with power, political structure or ideology. It assumes that all productive assets of the economy or the dominant part of them are in public ownership. Lange-Walrasian model advocates "market socialism" as a vision of an economy based on public ownership and coordinated by the

²⁰See Marx, Karl *Capital: A Critique of the Political Economy* Edited by Frederick Engels, New York, International 1981

²¹ See Marx, Karl and Frederick Engels *Manifesto of the Communist Party* Peking, Foreign Languages Press 1965, 504

²²See Marx, Karl and Frederick Engels *The German Ideology: including Theses on Feuerbach and introduction to The critique of political economy* New York, Prometheus Books 1998; see also Marx, K. *Capital, A Critique of the Political Economy* London, Electric Book Co. Vol. 1-3 2001

²³ See Lange, Oskar and Fred M. Taylor 'On the Economic Theory of Socialism' in Lippincott, Benjamin E. (ed) *On the Economic Theory of Socialism* Minneapolis, University of Minnesota Press 1938

²⁴See Walras, Leon *Elements of Pure Economics* Translated by William Jaffe. American Economic Association 1954

market.²⁵ In this Lange-Walrasian conception, socialism and market are compatible institutional and structural arrangements though such market conception does not entail the notion of private sector or private ownership.

Kornai's third interpretation of socialism is the Leninist-Maoist's interpretation of socialism,²⁶ which advocates the exercise of dictatorship of the proletariat and entrusts unshared power to the communist party. This interpretation resembles the second interpretation in the sense that public ownership is a fundamental feature of the system. More than that, the Leninist-Maoist position towards private property is confrontational, using political program with cruel force if necessary to confiscate, nationalize and collectivize private properties before and after taking power. In this interpretation, the role of market is replaced by central management, which is characterized by bureaucratic coordination, central control, and a system of enforcing instructions. Market coordination is expunged completely. Marxism is treated as sacrosanct and rejects all thoughts that are friendly to capitalism, to private ownership, and to the market.

Lastly, Kornai's fourth interpretation is the Western European's interpretation of socialism,²⁷ whereby socialism is articulated by the conception of social democracy²⁸ and is exemplified in countries such as Sweden, other Scandinavian countries, and at a later historical stage West Germany, and other countries in Western Europe. This interpretation advances a set of principles based on the idea of parliamentary democracy whereby social democracy does not

²⁵See Bardhan, Pranab K. and John E. Roemer (ed) *Market Socialism: The Current Debate* New York, Oxford University Press 1993; Also see Bardhan, Pranab K. and John E. Roemer (ed) *Market Socialism: The Current Debate* New York, Oxford University Press 1993

²⁶See Kornai, Janos *The Socialist System: The Political Economy of Communism* Princeton, Princeton University Press 1992

²⁷ See Kornai, Janos *The Socialist System: The Political Economy of Communism* Princeton, Princeton University Press 1992

²⁸Przeworski, Adam *Capitalism and Social Democracy* Cambridge, Cambridge University Press 1985

reject private ownership and rely on the market as the chief coordination of economic activities, though they are not for unfettered free competition and would insist on using the power of the state for income redistribution such as progressive taxation, subsidized education, health service, state pension, unemployment insurance, financial support for the poor, etc.

It follows from the above that, similar to the concept of capitalism, socialism is an ideology that is evolving. Indeed, it has evolved over times since its inception by Karl Marx. From the various interpretations, it appears that the evolution of capitalism and socialism in their respective ways have gradually reduced the differences between them. For instance, capitalist states have nationalization programs, public enterprises and assets; whereas socialist states have included market mechanisms, private ownership, and non-state decision making institutions.

Additionally, while capitalism can be conceived as a political economy with minimum content of private ownership and non-state decision-making, the notion of a market economy is only a necessary but not a sufficient condition for capitalism. In other words, while it is true that capitalism must encompass a market system, a market system must be encompassed by capitalism is not true. Socialism is a concept that is compatible with a market system.

Conceivably, market in its fundamental sense can be understood as a mechanism for coordinating human behavior,²⁹ and market, per se, is not attached to moral values or ideologies. Hence, capitalist market is a market that is operated, managed, or regulated based on capitalist ideology whereas socialist market is a market that is operated, managed, or regulated based on socialist values or ideologies. Regardless of the operating ideologies,

²⁹ See, for example, Samuelson and Nordhaus *Economics* Boston, McGraw-Hill 2001 for the concepts of market, and see Kornai, J. *The Socialist System: The Political Economy of Communism* Oxford and New York, Oxford University Press 1992 for general reference on socialist market system.

however, one fundamental characteristics of a market mechanism is that it must recognize and protect property rights of market participants. This market characteristic has an interesting offspring in the sense that a socialist system that embraces market economy has a tendency to recognize and protect private property rights over time.

Overall, in theory and practice, socialism can be understood as an ideology in its own right instead of a transient societal form, as Karl Marx had originally conceived. It is an evolving ideology that strives to achieve multiple goals comprising of both capitalistic and socialistic features. In this sense, if one is to view free market capitalism and the ideal of communist societies as two reference points, imperfect capitalism and socialism are all but different societal forms in between such two extremes. Further, imperfect capitalism and socialism, in their respective evolving forms, is no longer divided by capitalist values such as private ownership and market economy on one hand, and socialist values such as welfare disciplines and government intervention on the other hand. Socialist states can include traditional capitalist values, whereas capitalist states can advocate welfare disciplines and government intervention that are typical of socialist states. Socialism and imperfect capitalism are convenient labels to identify clusters of ideologies that share distinguishing features. While imperfect capitalism refers to the clusters that hold capitalist values and compel socialist ones, socialism on the other hand inclines to unify and aspires to both traditional capitalist and socialist values, to the extent that these values do not conflict with the socialist commitment of egalitarian society.

2.2 Chinese Interpretation - Socialism as Institutional Reforms

2.2.1 Ideological Perspective

The purpose of placing socialism in the context of an ideological spectrum is that socialism with Chinese characteristics, or Chinese socialism, can be interpreted as just yet another orientation of socialism along such ideology spectrum.

However, from closer examination, it can be seen that the Chinese interpretation of socialism does not fit into any of such interpretations. The reason is that the notion of private ownership, which is recognized by Chinese socialism, is outright incompatible with the Marxian, Lange-Walrasian and Leninist-Maoist's models, whereas the notion of parliamentary democracy, which is recognized by Western European's interpretation, is incompatible with the Chinese model.³⁰ Chinese socialism is distinguishable from capitalism in that public ownership remains the dominant form of national wealth ideologically,³¹ as evidenced in the development of land markets. And macroeconomic decision remains in the control of the state bureaucracy in practice,³² as demonstrated by its dual track market systems. Notably, market competition remains heavily tilted in favor of state-owned enterprises in China.

³⁰ See Kornai, Janos 'Socialism and the Market: Conceptual Clarification' in Kornai, Janos and Yingyi Qian (ed) *Market and Socialism: In light of the Experiences of China and Vietnam* New York, Palgrave Macmillan 2009, 22

³¹ Article 11, PRC Constitution, 2004. However, based on sources from National Bureau of Statistics, *China Statistical Yearbook* (Beijing: China Statistics Press), various years, GDP by ownership of the private sector has steadily increased over the years, from 33.8% in 1990 to 47.5% in 2001 as quoted from Wu, Jinglian 'Market Socialism and Chinese Economic Reform' in Kornai, Janos and Yingyi Qian (ed) *Market and Socialism: In light of the Experiences of China and Vietnam* New York, Palgrave Macmillan 2009, 39

³² See Naughton, Barry 'Market Economy, Hierarchy and Single-Party State Rule' in Kornai, Janos and Yingyi Qian (ed) *Market and Socialism: In light of the Experiences of China and Vietnam* New York, Palgrave Macmillan 2009

Obviously, the contemporary economic reform of the PRC has transformed Chinese socialism into a substantially different ideology from its inception as envisaged by Marx, Lenin and Mao. John Gettings in *The Changing Face of China* quotes Deng Xiaoping as stating:

"Planning and market forces are not the essential difference between socialism and capitalism. A planned economy is not the definition of socialism, because there is planning under capitalism; the market economy happens under socialism, too. Planning and market forces are both ways of controlling economic activity."³³

Arguably, although Chinese socialism encompasses the concept of market economy (and other capitalistic values) it does not mean that the regime will necessarily converge into a capitalist path.³⁴ This view can be reconciled with the perspective of the 'ideology spectrum' as discussed before. That is, to the extent that the ideology remains embodied with socialist goals and values, the additions of capitalist goals and values do not make it an 'imperfect capitalist system'.

Deng's articulation of socialism can also be understood from the perspective of Chinese pragmatics. I shall argue that the adaptation of socialism to Chinese conditions is essentially guided by way of Chinese pragmatics, hence the term 'socialism with Chinese characteristics'. Chinese socialism, as an ongoing manifestation of tensions between traditional socialist values and new socio-economic conditions in post-Mao China, is essentially a normative adaptation of socialism by local pragmatics, confined ultimately by the country's socialist commitment of an

³³ See Gittings, John *The Changing Face of China: from Mao to Market* New York, Oxford University Press 2005

³⁴ Ibid., p.23

egalitarian society. I shall elaborate on this point about the interplay of socialist ideology and Chinese pragmatics by way of an institutional perspective as follows.

2.2.2 Institutional Perspective

From an institutional perspective, Chinese socialism can be understood through the institutional changes of the Chinese political economy. To that end, I will conduct a normative analysis of the development of its constituent institutions, which broadly speaking is represented by socialist market economy, socialist democracy and socialist legal system respectively.³⁵ The normative perspectives of these institutions are elaborated in sub-sections below. In each instance, I argue that the respective socialist institution is in theory reconcilable with the socialist criteria and adaptable with advanced capitalist concepts such as private ownership, market economy, rule of law, parliamentary democracy, albeit with Chinese characteristics.

2.2.2.1 Socialist Market Economy

Socialist market economy, as a constituent of Chinese socialism, is important despite its non-existence in the early stage of the regime. The status of socialist market economy, or market economy with Chinese characteristics, was only formally recognized in the PRC Constitution in the early 1990s. In 1993, an amendment to the PRC Constitution was made to reframe Chinese socialism as below:

³⁵Preamble to the PRC Constitution, 1993

“China is at the primary stage socialism. The basic task of the nation is, according to the theory of building socialism with Chinese characteristics, to concentrate its effort on socialist modernization. Under the leadership of the Communist Party of China and the guidance of Marxism-Leninism and Mao Zedong Thought, the Chinese people of all nationalities will continue to adhere to the people’s democratic dictatorship and follow the socialist road, persevere in reform and opening to the outside, steadily improve socialist institutions, develop a socialist market economy, advance socialist democracy, improve socialist legal system and work hard and self-reliantly to modernize industry, agriculture, national defense and science and technology step by step to turn China into a socialist country with prosperity and power, democracy and culture.”³⁶

In 1999, another amendment was made to the PRC Constitution to define Chinese socialism by an institutional framework as follows:-

“Both the victory of China’s new-democratic revolution and the successes of its socialist cause have been achieved by the Chinese people of all nationalities under the leadership of the Communist Party of China and the guidance of Marxism-Leninism and Mao Zedong Thought, and by upholding truth, correcting errors and overcoming numerous difficulties and hardships. China will stay in the primary stage of socialism for a long period of time. The basic task of the nation is to concentrate its efforts on socialist modernization by following the road of building socialism with Chinese characteristics. Under the leadership of the Communist Party of China and the guidance of Marxism-

³⁶Preamble to the PRC Constitution, 1993

Leninism, Mao Zedong Thought and Deng Xiaoping Theory, the Chinese people of all nationalities will continue to adhere to the people's democratic dictatorship, follow the socialist road, persist in reform and opening-up, steadily improve socialist institutions, develop a socialist market economy, advance socialist democracy, improve the socialist legal system and work hard and self-reliantly to modernize industry, agriculture, national defence and science and technology step by step to turn China into a powerful and prosperous socialist country with a high level of culture and democracy.”³⁷

Hence, it can be said that the 1993 amendment has affirmed the Chinese path of adopting new contents into socialism, known as “Socialism with Chinese characteristics”. Implicitly, China affirms that it is not confined by the traditional notion of socialism and will not transplant socialism in a wholesale fashion from the outside world, but rather, it is going to develop its own version, including the adoption of a new normative interpretation, of socialism. In this sense, Chinese interpretation of socialism is said to be constituted by two components, one rooted to traditional socialist concepts and another characterized by local characteristics. In the next few chapters, I shall conduct historical and normative studies on these local characteristics. Suffice it to say, the doctrine of pragmatics, including its application in relation to the dynamic adaptation of socialism to local conditions as explained before, is an essential ingredient.

The 1999 amendment further proposes that such development of Chinese socialism will entail, among other things, development of three socialist institutions: (i) socialist market economy, (ii)

³⁷Preamble to the PRC Constitution, 1999

socialist democracy and (iii) socialist legal system. Among them, the concept of socialist market economy is particularly important. It was conceived as a vehicle through which the party-state plans and implements policies towards attaining its socialist goals. The concept of socialist market economy is therefore not a pure implantation of the market economy concept as understood by the West. Rather, it is an institution that is created and developed for the goals of Chinese socialism.³⁸

Indeed, socialist market economy has been a novel concept at its inception stage. Legal scholars compared the concept with market socialism³⁹ as implemented in Eastern Europe and claimed that China's original conception of market economy was properly based on the notion of market socialism, but was later transformed into a socialist market economy.⁴⁰ One scholar observes that China's adoption of market economy as one context of Chinese socialism implies that if a particular feature of market mechanism is viewed by Chinese policy-makers as being in conflict with maintaining the country's equilibrium towards its socialist aspirations, then such a feature may be discouraged or even prohibited.⁴¹ Potter argues that this is so to the extent that interest of market participants and the integrity of the market as a whole may be

³⁸ People's Daily Online, 16:09, October 09, 2008 – "From October 12 to 18, 1992, the 14th National Congress of the Communist Party of China was held in Beijing. Jiang Zemin delivered the report titled 'Speeding up reform and opening-up to win a bigger success on the cause of socialism with Chinese characteristics'. The report summarized the 14 years of experience since the Third Plenary Session of the 11th Central Committee of Communist Party of China and emphasized seizing the opportunity to speed up development. The report determined that the goal of China's economic system is to establish a socialist market economy and advocated arming the whole Party by Comrade Deng Xiaoping's theory of building socialism with Chinese characteristics." – accessed as of 16 July 2010 at <http://english.people.com.cn/90002/95589/6512397.html>.

³⁹ Note: market socialism refers to economic systems where means of production are either publicly owned or cooperatively owned for a profit in a market economy

⁴⁰ See Putterman, Louis 'China's Encounter with Market Socialism: Approaching Managed Capitalism by Indirect Means' in Kornai, Janos and Yiangyi Qian (ed) *Market and Socialism: In light of the Experiences of China and Vietnam* New York, Palgrave Macmillan 2009

⁴¹ See Potter, Pitman B. *From Leninist Discipline to Socialist Legalism: Peng Zhen on Law and Political Authority in the PRC* Stanford, Stanford University Press 2003

compromised.⁴² Potter's argument suggests that market itself is not a driving force of economic reform. It is the country's socialist goals, underpinned by its socialist aspirations and commitments, which are essential in driving the economic reform. From this perspective, the understanding of Chinese socialism is not about market economy per se, but from the socialist goals of the economic reform.

It can be recalled that China's socialist economic goals are to revitalize the state sector and improve the efficiency of state enterprises, and to adopt an open door policy to make use of foreign investment and advance technology for the modernization of the socialist economy in China.⁴³ According to Potter, the above twin goals of economic reform are the real driving forces of economic reform.

In this context, Potter's idea on economic reform can be translated into a statement about the evolution and adaptation of Chinese socialism. That is, the evolution and adaptation of Chinese socialism is not whether or not China is adopting capitalist ideas or marching towards capitalism per se, but instead is about whether the evolution and adaptation of Chinese socialism is consistent with the country's socialist aspirations or commitments. The interplay between China's socialist goals and Western market principles are forces that ensure the continuing tensions and thereby unique development of socialism with Chinese characteristics. Indeed, it will be argued that, in the course of market reforms, the Chinese state will attempt to intervene whenever and wherever socialist criteria of public ownership and macro-economic

⁴² Ibid.

⁴³ See Potter, Pitman B. *The Chinese Legal System: Globalization and Local Legal Culture* London and New York, Routledge 2001, 1; and see "Zhongguogongchandang di shiyijiezhongyangweiyuanhui id san ci quantihuiyigongbao" (Communique of the Third Plenum of the Eleventh CCP Central Committee), *Hongqi* (Red Flag) 1979, no. 1, 14-21

control are challenged at core. That is, in respect of the insistence to the socialist criteria of public ownership, the Chinese state continues to privilege public forms of land ownership while allowing co-existence of public and private forms of capital ownerships. Furthermore, in respect of the insistence to macro-economic control, the Chinese state continues to adhere to central planning on long term economic issues, notwithstanding the growing importance of the private sector of the market economy. As such, local characteristics, including Chinese pragmatics, play a key role in shaping the development of the socialist market economy to the extent that any compromise to its socialist characteristics shall be confined by the country's socialist aspirations and commitments, a point to be further illustrated by way of case studies of the next chapters.

I argue that the above translation is consistent with the facts revealed in Zhao Ziyang's memoir where Zhao has quoted Deng's views on the relations between socialism and market economy. According to Zhao, Deng said "socialism does not exclude a market economy".⁴⁴ Deng had also been quoted as telling to his comrades that in combining planned and market economies, they could be flexible as to which was actually playing the leading role.⁴⁵ Notwithstanding, as early as 1984, the 3rd Plenum of the 12th Central Committee had passed the "Decision on Economic Reform" which among other things merely defined the economy of socialism as that of the commodity economy – quite a different thing of a market economy.⁴⁶

In fact, China's conception of market economy did not linearly evolve and develop. Two prominent Chinese leaders, Chen Yun and Li Xiannian, had always emphasized the importance

⁴⁴ See Zhao, Ziyang *Prisoner of the State: the Secret Journal of Zhao Ziyang* London, Simon & Schuster 2009, 119

⁴⁵ Ibid.

⁴⁶ Ibid.

of a planned economy, especially Chen Yun, whose views had not changed since 1950s.⁴⁷ Chen advocated the well-known “Birdcage Economic Model” which suggested that “the economy was like raising birds: you cannot hold the birds too tightly, or else they will suffocate, but nor can you let them free, since they will fly away, so the best way is to raise them in a cage”.⁴⁸ Chen included the phrase “planned economy as primary, market adjustment as auxiliary” in many speeches.⁴⁹ According to Zhao, the tone of Chen’s speeches did not change even after the reforms were well under way.⁵⁰

Hence, socialist market economy can be understood as the socialist mandate to the party-state to ensure that whatever limited degree of private economic activity might be required to meet the needs of society will not result in severe disparities in wealth and consumption.⁵¹ From this perspective, the different view of Deng and Chen on the concept of socialist market economy differs in detail implementation approach but is reconcilable at the ideological level. Put it differently, in reconciling such different views, it is conceivable that the socialist commitment of egalitarian society is the birdcage, rather than central planning as the birdcage, in which both planned economy and market economy can coexist or even interplay.

That said, however, it is important to see that the market economy, albeit with Chinese characteristics, needs to function essentially as a market system, regardless whether or not it is within a socialist or capital framework. I argue that, from a global perspective, state

⁴⁷ Ibid., p.120

⁴⁸ Ibid., p.120

⁴⁹ Chen, Yun *Selected Essays of Chen Yun: 1965-1985*, Renminchubanshe (People’s Press), Beijing 1986

⁵⁰ Zhao, Ziyang *Prisoner of the State: the Secret Journal of Zhao Ziyang* London, Simon & Schuster 2009, 120

⁵¹ Potter, Pitman B. *From Leninist Discipline to Socialist Legalism: Peng Zhen on Law and Political Authority in the PRC* Stanford, Stanford University Press 2003, 140

intervention or policy compromise is not unique to the Chinese context. The distribution of wealth and consumption from economic productions is a policy matter that concerns all countries. The means of achieving such goal varies from country to country. Simply put, compromises of policy makers are a fact of reality, whether it is under Chinese socialism or otherwise. Chinese notion of market economy is compatible with the Western notion insofar as compromise is a necessary condition for achieving ideological goals. Any “impurity” of the concept of Chinese market, as compared with the West, is a matter of difference in priority of the ideological goals. The socialist market economy’s emphasis on the state’s ability to perform macro control, while individuals are allowed to conduct their activities in accordance with market competition is reconcilable with capitalist market economy’s emphasis on the state’s restraint to steer away from intervention, so as to allow individuals to conduct their activities to the fullest extent of market competition. These alleged impurities and ideological differences therefore converge at the operational level where intervention, manipulation and regulation are all means for achieving the respective goals.

2.2.2.2 Socialist Legal Regime

From the above, socialist market economy, as an evolving constituent of Chinese socialism, serves to define and distinguish Chinese socialism from capitalism. The distinguishing element lays in the local characteristics component of its socialist ideology.

In this section, I shall discuss the second constituent institution, the socialist legal system.

Traditionally, in a socialist regime that is premised on a Marxian ideology, legal system is an institution that exists and functions as an instrument for regulating economic relations of actors

of the society. Based on the Marxian concept, economic relation exists at the “base” whereas law exists at the “superstructure”,⁵² and as the base determines the essence of the superstructure, economic relations shapes the ultimate shape and form of the legal regime. That is, if the economic relations of the political economy are vertical in nature, such as one between state and individuals, then law exists at the superstructure for this vertical relation by way of, for example, public laws that govern relations between state and individuals. But if the economic relations are horizontal in nature, such as one between individuals, then law exists at the superstructure for these civil relations by way of, for example, private laws that regulate relations between individuals.

Prior to economic reform, economic relations of the Chinese economy were predominantly vertical in nature. However, as market reform has changed the economic relations at the base, the function of law has also changed at the superstructure. That is, economic relations at the base are now both vertical and horizontal in nature. With the economic reform, law serves both as a governor and a regulator – governor for vertical relations and regulator for horizontal relations. In particular, law’s response to the emergence of horizontal relations of a Chinese market economy has fundamentally changed the role of law in Chinese socialism. For one reason, the role of law of a market economy is not only instrumental but is also ideological, because the market embodies normative concepts such as fairness, right and just. The role of law of a market economy must function as a regulator and governor. This implies that the

⁵² See Marx, Karl *A Contribution to the Critique of Political Economy* Translated from the German by S.W. Ryazanskaya with introduction by Maurice Dobb. New York, International Publishers 1970

Marxian formulation of base-superstructure model is not entirely adequate in explaining and understanding the new development of legal regimes of Chinese socialism.

In the above regard, I shall apply a sociological formulation of law that explains the dynamics between law and society for the new developments. According to the socio-economic theory, law shapes social norms inasmuch as social norms shape law.⁵³ In this way, by conceiving law as an ideology rather than as an instrument, the norms of a market will play a role in shaping the norms of the regulatory regime of the market, which may or may not be consistent with CCP's view at any point in time. Consequently, the rule of law, as a norm in the Western notion of market economy, can therefore shape the norms of the Chinese socialist market. However, the interplay of rule of law with the socialist legal regime raises a fundamental question. Does Chinese socialism recognize the concept of rule of law? Is rule of law compatible with the socialist legal regime in China? If so, does the Western notion of rule of law bear the same meaning as the Chinese version? These questions will be dealt with in the later part of this chapter. Suffice it to say, with respect to the first question, it will be shown that through an incremental and iterative process, market as a property rights infrastructure has indeed fostered the recognition and aspiration of the concept of rule of law in China.

Just as the Chinese concept of a market system is not the same as a Western model, the concept of rule of law in China can conceivably be different from those of the West. One scholar offered a plausible explanation in that the Chinese concept of rule of law can be different due to its political morality, although he maintained that, at the core, concept of rule

⁵³ See Etzioni, Amitai Social Norms: Internalization, Persuasion and History (2000) 34, no. 1 *Law & Society Review* 157-178

of law does carry a consensus meaning.⁵⁴Peerenboom argued that conceivably, the notion of rule of law in socialism and capitalism is reconcilable to the extent that a socialist state would endorse a state-centered socialist rule of law defined by a socialist form of economy and an interpretation of rights that emphasize stability, collective rights over individual rights, and subsistence as the basic right rather than civil and political rights, whereas a capitalist state would endorse a civic-centered democratic rule of law defined by a capitalist form of economy and rights that emphasize individualism, liberalism and human rights.⁵⁵As long as the minimum content of rule of law is satisfied, such as its ability to impose limits on the party-state, then theoretically, Chinese socialism does not necessarily preclude a formal adoption of the rule of law into its legal system merely on grounds of its political morality. The state, however, will intervene whenever and wherever socialist criteria of political system and rhetoric ideology are challenged at core. That is, similar to the above argument, local characteristics, including Chinese pragmatics, plays a key role in shaping the development of a socialist rule of law to the extent that any compromise to its socialist characteristics that is to be made shall be confined by the country's socialist commitment. Although it is not clear what shape and form a rule of law with Chinese characteristics is going to look like, China's adoption of a market system and a property rights infrastructure will necessarily foster the evolution of the concept of rule of law in the long run. By borrowing Potter's argument as outlined before, it is conceivable that China's legal system will evolve through the interplay between China's socialist goals and the Western concepts of rule of law. On the other hand, China's socialist aspiration and

⁵⁴See Peerenboom, Randall P.*China's Long March Towards Rule of Law*Cambridge, Cambridge University Press 2002

⁵⁵*Ibid.*,pp.1-54

commitment will be adhered to in the case that the Western concept of rule of law conflicts with its over-arching socialist commitment. At this stage, China's legal regime is adaptable if and only if the notion of rule of law is compatible with those required for its socialist market economy. Hence, if one is to limit the scope of rule of law to the concept of "market rule of law", then it is plausible that China's socialist legal system is adaptable to the concept of rule of law as its socialist market economy is adaptable to market economy.

2.2.2.3 Socialist Democracy

The third constituent institution of Chinese socialism is socialist democracy. By nature, the institution of democracy has a controversial context. While Chinese leaders are not clear with the modern conception of socialist democracy, it is clear that the idea of a universal notion of democracy is not compatible with Chinese socialism. Hence, in order to understand the institution of socialist democracy in China, it is necessary to inquire into the fundamental values and contents of such institution.

One scholar suggests that the study of socialist democracy is a study of the basic notion of people.⁵⁶ In Chinese, the word democracy (民主) literally means "rule by the people". Nathan argues that "people" is an all-inclusive concept, which includes individuals as well as generally all members of society, where society is an aggregation of individuals and a plurality of diversified social groups and interest.⁵⁷ Nonetheless, such concept is distinguishable from the orthodox concept of Chinese socialism where "people" is both a social class concept and a

⁵⁶Nathan, Andrew J. *China's Crisis: Dilemmas of Reform and Prospects of Democracy* New York, Columbia University Press 1990, 172

⁵⁷ Ibid.

collectivist or community-centered concept. That is, as a social class, people refers to the ruling classes within the society and is the opposite of the enemy classes, such that democracy is to be exercised among the people while dictatorship is to be exercised over the enemies.⁵⁸ Under such notion, democracy is a substantive matter, which is characterized by how the interests of the people are served. This is in contrast with the procedural notion that democracy is concerned with a competitive leadership selection procedure that establishes a formal contract to rule for a fixed period.⁵⁹ The difference between substantive and procedural notions is that, in the former, democracy is to mean, “care for the people”, as a moral obligation of the ruler toward the ruled rather than, in the latter, as an institutional control of political authority by the people themselves.⁶⁰

Based on this formulation, under the conception of Chinese socialism, “people” is to be conceived as not all-inclusive, but denotes merely the part of the society where democracy applies. That is, “people” refers to a collective entity that transcends the fundamental and unified interests of its individual members, such that these interests can only be represented in a highly centralized way by the vanguard party of the proletariat and that democracy is to be practiced under the guidance of the center.

⁵⁸ Notes: Socialist democracy, in the Leninist sense, is understood in two dialectical relations, expressed in two seemingly self-contradictory terms: democratic dictatorship and democratic centralism. It refers to “the people” collectively pursuing their unified fundamental interests and exercising dictatorship over the enemy classes – a minority of people in certain socioeconomic and political categories. Democracy means rule by the party centre in the interest of the people. Theoretically, the party has no special interest of its own and acts solely on behalf of the most fundamental, unified, and long-term interests of the people. Further, this notion of democracy implicitly assumes the fundamental harmony of interests between ruler and the ruled, and the popular support for a powerful government, rather than individual rights, diverse social interests, and limited government.

⁵⁹ Nathan, Andrew J. *China's Crisis: Dilemmas of Reform and Prospects of Democracy* New York, Columbia University Press 1990, 172

⁶⁰ Womack, Brantly ‘In Search of Democracy: Public Authority and Popular Power in China’ in Womack, Brantly (ed) *Contemporary Chinese Politics in Historical Perspective* Cambridge, Cambridge University Press 1991, pp.59-85

Chinese interpretation of socialist democracy is about goods instead of rights, collective instead of individuals, practice instead of procedure, objective instead of subjective interest, and social mobilization instead of voluntary participation.⁶¹ This interpretation is particularly relevant to the present inquiry in that it affirms the non-universal notion of democracy and offers a plausible normative description of socialist democracy in China.

However, democracy based on the concept of unity interest is flawed within the contexts of the latest economic reform. Socialist democracy need to face increasingly pluralistic interests of changing Chinese culture brought about by the economic reform. Empirical evidence, recognized by the Chinese reformer, indicates that significant cultural change is taking place in contemporary China, with a growing gap between the orthodox culture and the mass culture. For instance, there are an increasing number of Chinese people today who have developed an awareness of the distinction between the state and the society as different objects of political identification and have come to view the state as a political entity that is separate from society. Additionally, a widespread crisis of faith in the orthodox ideology in the midst of rising individualism and materialism is seriously challenging the traditional and orthodox cultural values. Lastly, there is an overall tendency of Chinese people today who move toward cultural differentiation of society from the state.⁶² In 1999, the PRC Constitution was amended to stipulate that the socialist democracy institution shall be “advanced” in the context of socialism with Chinese characteristics as economic reform has rendered class enemies as insignificant or unimportant. Put in other words, the meaning of “people” shall be advanced from a social class

⁶¹Ware R. ‘What Good is Democracy? The Alternatives in China and the West’ in Parel A.J. and Keith R.C. (eds) *Comparative Political Philosophy*, Sage Publications 1992, pp.115-140

⁶²See Ding, Yijiang *Chinese Democracy After Tiananmen* Vancouver, UBC Press 2001, pp.116-118

to a nearly all-inclusive group that is identical to a society, and “internal dynamics and motivation of social change” shall be advanced from class struggles to the contradictions among the people. Furthermore, the meaning of “dictatorship” shall be advanced to social management and reconciliation, while “centralism” shall be advanced to provide a limited degree of decentralization and division of power.

With this “advanced” notion of socialist democracy, the primary function of the State is not to maintain dictatorship but to recognize the differences between pluralistic interests of the state and society, as well as cultural and ideological change toward individualism and materialism. Socialist democracy is to be understood as freedom of society from state and as societal control of the state. Democracy is not only a collective, objective and participative matter, but it is also a contraction of the state such that the autonomous realm of social and economic life is appreciated and protected. Moreover, democracy is not only a substantive matter but is also a process of accommodation, coordination, and compromise among interests in a pluralistic society.

In 2004, the PRC Constitution was amended to stipulate that Chinese socialist democracy is to be advanced from the Leninist model to the “Three Represents” model where the communist party not only represents the fundamental interests of the people, but also the advanced productive forces and the advanced culture.⁶³ The idea of “Three Represents” justifies communist-party leadership over the state while recognizes the importance of the advanced productive forces and the advanced culture as represented by the educated and the propertied

⁶³Killion, M. U. The Three Represents and China’s Constitution: Presaging Cultural Relativistic Asian Regionalism, 14, Summer 2004, *Currents International Trade Law Journal*

classes, rather than the industrial working class. Notwithstanding, the “Three Represents” is just one small step of a long journey towards the idea of socialist democracy, as democracy is not about the domination of society by an unlimited state power but it is about the control of a limited state by an independent society and the accommodation and coordination of diverse social interests. In this respect, Chinese democratic reform requires a political reform to an extent that the party-state formula of governance no longer applies – an ideological breakthrough similar to what marketization has done to horizontal relation and rights protection in economic and legal institutions respectively.

It is noteworthy that marketization has caused the emergence of a pluralist value-based civil society, which is seen as one building block of socialist democratic institutions of the PRC. From a procedural perspective, the existing political system insists that one party leadership is incompatible with the Western notion of parliamentary democracy. Nevertheless, from a substantive perspective, China’s ideological shift towards a pluralist value-based civic society that is brought about by economic reform is compatible with the advanced notion of socialist democracy. Hence, in the context of economic reform, the advanced notion of socialist democracy is an adaptable and evolutionary concept, albeit it remains unclear when, and how substantively, marketization movement will bring about similar breakthrough in socialist democracy in China.

2.3 Iterative Interpretation - Chinese Socialism as Normative Iterations

In summary, from an ideological perspective, socialism represents one class of socialist ideologies along the capitalist-communist ideology spectrum determined by the degree of state

intervention and public ownership. Chinese socialism is one interpretation of socialism at any particular point in time. From an institutional perspective, Chinese socialism is represented by its constituent institutions, all of which are evolving and adaptable concepts and reconcilable with Chinese socialist aspirations and commitments.

The evolutionary and adaptability characteristic of Chinese socialism brings up an important question – that is, what is the essence of Chinese socialism? If Chinese socialism is evolving and adaptive, then does it contain any normative parts that remain constant over time? And, in the context of economic reform, especially with market reform, how will tensions between China's socialist goals and Western notions of market economy, rule of law or democracy resolve themselves over the long run? Lastly, how will Chinese socialism evolve over time and what will it evolve into over the long run?

To examine these questions, it is inadequate to only look at the static relations between the constituent institutions. Instead, an iterative process that explains the dynamic relations between these constituent institutions is required. In this regard, I shall argue that Chinese interpretations of market economy, rule of law and democracy can be, and indeed has been, “advanced” iteratively to the extent that these institutions are to be shaped and reconciled with China's socialist goals over times. I shall refer to this advancement as a “normative iterative process”.

Based on the normative iterative process, for example, economic institutional reform can be understood as changes caused by its own reform policy as well as feedbacks from other institutions induced by its own changes. It is an iterative process because economic reform is

not conceived as a grand strategy with deliberation at the outset, but rather is made up of a series of experimental, incremental and evolutionary policies.⁶⁴ It is a normative process because each of the iterations involves the interplay of conflicting institutional norms and socialist goals.

The normative iterative process occurs in both local and global dimensions. The local dimension corresponds to an iterative reform process whereby local institutions are reformed by local initiatives such as economic, legal and socio-political policies. The global dimension corresponds to movements such as global capitalism and global rebalancing. The global dimension also carries an additional context whereby local movement attempts to influence global institutions. Chinese socialism will therefore be subject to influences of global institutions as much as these global institutions will be subject to influences of Chinese socialism. The so-called “Beijing Consensus” is one theory that advocates the merits of adopting certain principles and norms of Chinese socialism in the global stage. The rise of the “G20 Forum” after the global financial crisis of 2008-2009 serves as concrete evidence where Chinese socialism exerts influence on global reforms. The iterative model provides an analytical tool where Chinese socialism acts as a source of global movements in the same way as global movements have been a source of influence of Chinese socialism. In the following sections, the local aspect that concerns interplays of Chinese socialist institutions will be discussed first, followed by the global aspect which focuses on interplays between Chinese socialism and global institutions.

⁶⁴See Wei, Yuwa *Securities Markets and Corporate Governance: A Chinese Experience* Surrey, Ashgate Publishing Limited 2009, 11

2.3.1 Local Movement

At least one scholar has pointed out that economic reform can be expressed in terms of two broad processes: one involves the transition to a market economy, which embodies elements that are common to all market transitions, most prominently the shift from bureaucratic control of resources to market-determined allocation. Another is the structural transformations, which are the corresponding shifts in the nature of political and economic power, and the reinforcement of the social changes associated with market transition.⁶⁵

While the above observation is fundamentally correct, its application is limited to one stage of the economic reform process. Two criticisms can be raised in this regard. One concerns with the static nature of this theoretical framework. That is, the observation applies to how market reform affects economic reform through uni-directional processes, but fails to address the dynamics or more specifically the iterative aspect of these processes. In other words, it is important to inquire not only how market reform affects economic reform, but also how market reform is being affected by its own self as well as its own constituent structural derivatives. The other criticism concerns the limitation of the scope of theoretical framework. Specifically, it is important to place the contemporary economic and market reform of the PRC in the context of local and global institutional changes. I will elaborate on the above two criticisms below.

2.3.1.1 Economy and Law

⁶⁵ See Naughton, Barry 'China's Transition in Economic Perspective' in Goldman, Merle and Roderick MacFarquhar (ed) *The Paradox of China's Post Mao Reforms* Cambridge, Harvard University Press 1999, pp. 30-31

As pointed out in the above, market reform necessarily affects two broad areas: one is the market mechanism itself and another is the market regulation that governs such mechanism. More importantly, as I shall argue, these two broad areas affect each other in an iterative manner.⁶⁶

To illustrate this argument, let us consider the following chain of events. Market changes such as an introduction of new technology, an entrance of new player, a shift in consumer demand, or a scandal that reveal new information about the operation of the market or its participants raise new questions about the changes. As a result, this will then create new tensions and uncertainties, which in turn will induce legal response to mitigate such tensions to restore the equilibrium back to the market. The legal response in turn creates new incentives and often new uncertainties for market players, who then adapt their conduct to the new rules and push at the margins of the new legal order. These market reactions then raise further new questions of their own, which prompt for further legal response, and the process repeats itself iteratively. Accordingly, once a market incentive is introduced, the participation of market players and the dynamics between market mechanism and market regulation will interplay iteratively to continuously develop the market.

In fact, scholars of Chinese law have long argued that economic reform is the driving force for administrative⁶⁷ and legal reform⁶⁸ in China, though the converse is not immediately obvious.

⁶⁶ See Milhaupt, Curtis J. and Katharina Pistor *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World* Chicago, The University of Chicago Press 2008

⁶⁷ See Peerenboom, Randall P. *China's Long March Towards Rule of Law* Cambridge, Cambridge University Press 2002

⁶⁸ Potter, Pitman B. *From Leninist Discipline to Socialist Legalism: Peng Zhen on Law and Political Authority in the PRC* Stanford, Stanford University Press 2003

To see this, I shall apply the institutional theory formulated by North, where institutions are understood as humanly devised constraints that shape human interaction, to explain how legal institutional changes affects economic development.⁶⁹ In this regard, by conceiving law reform as institutional changes, it can easily be seen that law reform will indeed affect economic development. Intuitively, incremental regulatory change can be understood as a vehicle for connection between past economic changes with the present and the future. Put differently, economic development can be conceived as an incremental story of the evolution of regulations in which the historical performance of economic development, including market reform, can be understood as a part of a sequential story of regulation changes.

From the above, it follows that not only economic reform drives and shapes legal reform, but the converse is also true. The implication of this iterative perspective is that Chinese economic reform should be properly viewed as a catalyst to economic institutional changes and subsequently legal institutional changes. Once the reform process has commenced, legal reform as well as economic reform will gain a life of its own and will shape its own institutions. That is, legal reform will proceed based on its own institutional considerations, and at the same will affect economic reform (as a feedback), in an iterative manner between the two institutions.

2.3.1.2 Law and Political Society

Having demonstrated the iterative relationship of economy and law, I shall now expand the scope to include law and political society. To argue for this, I shall apply the socio-economic

⁶⁹North, D. *Institution, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press 1990

theory of law that explains the interplays between law and social norm or popular culture.⁷⁰

This theory suggests that law and social norms are linked in an “iterative process”.⁷¹ For example, by introducing law that prohibits smoking in restaurants, this causes a change in the behaviors of the customers of the restaurants. Further, as individuals perceive this change as a good thing, they internalize the preference and change their behaviors in other public places. Eventually, this preference becomes a norm that shapes individual behaviors. According to the theory, law as norms shapes human behaviors not only in economic transactions but also in non-economic spectra of daily lives. Conversely, as individuals manifest their preferences and choices based on their social background, and since preferences do not stay constant but are changeable through persuasion and then internalized as intrinsic predispositions, norms are developed through the internalization process when the intrinsic predispositions serves as internal norms and in turn shapes the individual behaviors and choices. This process continues so on and so forth iteratively.

Hence, social norm can shape individual behaviors and choices, and therefore everyday life encounters has a similar architect as laws. Therefore, popular culture is a source of law as much as law is a source of popular culture.⁷² Law as norms is a manifestation of the popular culture developed by internalization of individual preferences as intrinsic predispositions.

⁷⁰See Jutras, Daniel The Legal Dimension of Everyday Life (2001) 16, no. 1 *Canadian Journal of Law and Society* 45-66; see also Etzioni, Amitai Social Norms: Internalization, Persuasion and History (2000) 34, no. 1 *Law & Society Review* 157-178; see also Howes, David Law as a Source of Popular Culture and Popular Culture as a Source of Law (1995) 10, no. 2 *Canadian Journal of Law and Society* 1-4

⁷¹Etzioni, Amitai Social Norms: Internalization, Persuasion and History (2000) 34, no. 1 *Law & Society Review* 157-178

⁷²Howes, David Law as a Source of Popular Culture and Popular Culture as a Source of Law (1995) 10, no. 2 *Canadian Journal of Law and Society* 1-4

The implication of this iterative theory, as applied to law and society, is far reaching. Taking market reform as an example, the aspiration of right based market mechanism as transpired by China's socialist market economy will in time trigger a process whereby the aspiration or preference of the concept of rule of law may be persuaded and internalized as intrinsic predispositions of individuals in China. Conceivably, CCP members and government policy makers will similarly be persuaded and internalized towards the concept of rule of law. This internalization will have an effect on legal reform policies not only in relation to market segment in particular but also on non-market segments in general. Similarly, taking private ownership as another example, the aspiration of pluralist value-based society as transpired by the notion of pluralist interests or private ownership will trigger a process in which such aspiration or preference will be persuaded and internalized by individuals, CCP members and government policy makers in China. As the protection of rights of pluralist interests becomes a popular culture, the sphere of private ownership will expand.

The iterative process ensures an ongoing development which will reinforce popular culture as a source of law and law as a source of popular culture, provided arguably such development must be consistent with the confines of the socialist goals. The latter qualification then brings up the last leg of the iterative model (i.e. the iterative relation between economics and politics).

2.3.1.3 Economy and Politics

To see the relation between politics and economic reform, it is best to envisage the relations as a forward direction and a backward direction respectively. The forward process, which refers to the effect of politics on economic reform, is self-explanatory. Hence, I shall only focus on the

backward process, which refers to the effect of economic reform on politics. At least one scholar has suggested that the entire economic reform is not pre-conceived at the outset in the form of a grand strategy. But rather, such reform policy is often conceived as an immediate response to the previous reforms.⁷³ In particular, policy towards economic reform was deepened and broadened only because the initial phase of the reform has proved to be fruitful. Policy makers decided to take further reform steps in respect of the state-owned enterprises and the domestic financial system, since the market reform had necessitated such responses.

Again, the iterative relation between economy and politics is far reaching. For instance, economy affects politics by way of movements within the Chinese socialist institutions. Notably, as a result of economic reform, power of the party-state is either released from public to private or decentralized from central to regional segments, resulting in a dynamic economy with declining party-state.⁷⁴ For another instance, economic policy towards market and private ownership completely changed the socialist ownership structure and thereby the political landscape of the traditional Marxist-Leninist-Maoism regime.

Indeed, many more examples can be found to demonstrate the iterative process of institutional change. For instance, the policy to separate ownership and management of state enterprise has evolved into a series of economic reform policies toward state owned enterprises, which in turn promotes further policies to reform the state-owned enterprises and the political

⁷³ See Kornai, Janos 'Socialism and the Market: Conceptual Clarification' in Kornai, Janos and Yingyi Qian (ed) *Market and Socialism: In light of the Experiences of China and Vietnam* New York, Palgrave Macmillan 2009, 22

⁷⁴ See Goldman, Merle and Roderick MacFarquhar 'Dynamic Economy, Declining Party-State' in Goldman, Merle and Roderick MacFarquhar (ed) *The Paradox of China's Post-Mao Reforms* Cambridge, Harvard University Press 1999, pp.3-29

organization that is interleaved with these state enterprises; the policy to formalize property rights and legal persons modernized the Chinese legal regime and prompted for further policies to improve the system; and the emergence of a private sector and the growing importance of this sector have created a pluralist value-based civic society, which in turn prompts political reform, such as the “Three Represents”. I shall return to this subject again in the case studies of capital and land markets in Chapter 3 and 4.

2.3.2 Global Movement

I now turn to the global processes of iterative institutional change. To start with, it is trite that the interplays of economy and law, law and political society, economics and politics are not limited to local movements. China’s open door policy which aimed to promote foreign trade and regulatory and political exchange has prompted profound changes in its socialist institutions by way of a normative iterative process similar to the one mentioned before. Specifically, the global movement arises in the context of Chinese economic reform where global initiatives play a significant role on local institutional changes. Two global movements are of particular importance. One movement refers to the rise of global capitalism from 1980s up to early 2000s, including the impact of China’s accession to the World Trade Organization starting at the turn of the 21st century. Another movement refers to the new initiatives taken after the global financial crisis of 2008-2009, sometimes referred to as the global rebalancing initiative, including the emergence of G20 as a global institution in coordinating world economic orders and the movement to balance current account surplus and deficit among G20 member countries. In the first instance, global capitalism is an external force in shaping

Chinese socialist reforms and thereby Chinese socialism. In the second instance, global rebalance is an external event where Chinese socialism exerts influence in shaping the world's new eco-political order. Similar to local movements, these global movements do not operate independently but can be argued as also being engaged in an iterative process. The iterative theory of economics, law and politics is transcended to a global context in so far as Chinese reform is concerned. In this respect, China's engagement into G20 and other new rebalancing initiatives is a force that will eventually feed back into local reforms in the longer run. I shall elaborate as follows.

2.3.2.1 Global Capitalism

The first global movement that plays a significant role in Chinese reform is global capitalism. This term refers to the recent stage of the capitalism from about 1980 to present when capitalism is characterized by a phenomenon of excess of capital that has outgrown the nation state through which capitalism was previously developed. This period of capitalism is characterized by cheap, flexible, deregulated and de-unionized capital-labour relations, and represented by an expansion appetite whereby many countries previously outside the system are then incorporated into the system. During this period, capitalism has expanded to include global institutions such as World Trade Organization, the International Monetary Fund, the World Bank, multilateral and bilateral free trade agreements, and all kinds of global legal structures that assimilate the parallel of national-states. Ideologically, these institutions are advocated by programs, which seek to create conditions to facilitate free flow and

accumulation of capital across borders.⁷⁵ The transnational characteristic of global capitalism has given unprecedented powers to Western capitalists. These powers are centralized and concentrated not in a nation-state, but in transnational capital itself and the class of individuals who control this capital, otherwise known as the transnational capitalist class.⁷⁶

Indeed, global capitalism has expanded not only among the Western economy but has successfully penetrated into the Chinese economy, albeit limited by way of a selective and adaptive process locally.⁷⁷ One global institution that is particular influential in shaping local Chinese economy is the World Trade Organization (WTO).⁷⁸ Economically, WTO is rapidly assuming the role of a global government.⁷⁹ Legally, the WTO represents a rule-based regime of economic globalization founded on two core principles: non-discrimination and national treatment.⁸⁰ By way of the non-discrimination rule, a WTO member cannot impose one level of barriers (e.g. tariffs) against a state and another level for others, and by way of the national treatment rule, a WTO member is required to treat foreign firms no less favorably than as domestic firms in its local economy. These two WTO rules are basic ingredients of a global market. Also, more importantly, WTO members are mandated to participate in a rule of law

⁷⁵ Robinson, W.I. *Understanding Global Capitalism* [Online], Scholarship Repository, University of California, 2008. Available from: <http://repositories.cdlib.org/gis/46>.

⁷⁶ Ibid.

⁷⁷ See Potter, Pitman B. *The Chinese Legal System: Globalization and Local Legal Culture* London, RoutledgeCurzon 2003

⁷⁸ Notes: WTO is an international organization designed to supervise and liberalize international capital trade. The organization officially commenced on 1 January 1995 under the Marrakesh Agreement, replacing the General Agreement on Tariffs and Trade (GATT), which commenced in 1947.

⁷⁹ WTO Official Website as at 14 November 2009 [Online]. Available from: http://www.wto.org/english/thewto_e/whzatis/tif_e/org6_e.htm. Notes: WTO has 153 members as of 23 July 2008.

⁸⁰ Frost, E.L. "China, the WTO, and Globalization: What Happens Next, Peterson Institute for International Economics" in ChinaOnline Website 19 July 2001 [Online]. Available from: <http://www.iie.com/publications/papers/paper.cfm?ResearchID=416> as at 10 January 2010.

based dispute settlement system.⁸¹ Under this system, if one WTO member is accused of violating the rights of another, and if negotiations fail, it must submit to a dispute settlement process. Based on the dispute resolution principles articulated in the WTO Understanding, the WTO members are expected to comply with decisions made by the Dispute Settlement Body of the WTO. In particular, the dispute resolution principles make reference to arbitration that brings into play the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards and the Washington ICSID Treaty, thereby demands national judicial systems to act in compliance with existing international treaty obligations and norms, but in an expanded range.⁸²

Therefore, China's accession to the WTO has triggered considerable economic and legal reforms. Economically, China is required to reform its socialist economy in line with the basic characteristic of a market system. Legally, even though WTO does not directly interfere with the local jurisdiction, the rule-based institution serves as a source of legal norms in shaping legal reforms in China. Such influence is far more important to have a persuasive and profound change in culture than merely in written laws.⁸³ From this perspective, the impact of China's accession to the WTO lay in the Accession Protocol as well as the transition arrangements of the Protocol.⁸⁴

⁸¹ Ibid.

⁸² See Potter, Pitman 'The Evolution of Law in Contemporary China: Challenges for WTO Implementation' in Ostry, Sylvia and Alan S. Alexandroff (ed) *China and Long March to Global Trade: The Accession of China to the World Trade Organization* New York, Routledge 2002, 136

⁸³ See Ostry, Sylvia 'WTO: Post Seattle and Chinese accession' in Ostry, Sylvia and Alan S. Alexandroff (ed) *China and Long March to Global Trade: The Accession of China to the World Trade Organization* New York, Routledge 2002, 19

⁸⁴ Ibid.

Ostry argued that China's accession to the WTO is a part of a larger strategy of massive and fundamental economic reform⁸⁵ in which the WTO serves as an external anchor to support and sustain the economic reform launched in the 1980s.⁸⁶ Ostry cited two possible interplays between WTO and institutional reforms in China that supports the above arguments. First, the WTO will enhance reform prospects at the expense of the unemployment in capital-intensive industries and rural areas, thereby prompting social reforms in welfare safety net and other forms of adjustment assistances.⁸⁷ Second, Article X and the concept of transparency in the GATT/WTO will go to the heart of China's legal institution, thereby prompting its administrative legal infrastructure to go through extensive transformation before full and effective WTO integration is possible.⁸⁸

By its very nature, WTO's dispute settlement system and its requirement on transparency runs counter to China's insistence on non-interference of domestic affairs. However, by its accession to the WTO, China has implicitly, albeit selectively and adaptively, entered into the age of globalization. As such, what Chinese governments do in the management of their domestic economy may matter more to foreign competitors than at their borders. Chinese policy makers is aware that globalization, in particular economic globalization, is a movement towards a global market guided by a harmonized legal and regulatory framework, a sense of political community and shared purpose, a stable security system, and common standards of

⁸⁵See Clark, Donald C. China's Legal System and the WTO: Prospects for Compliance (2003) 2, no. 1 Washington University *Global Studies Law Review* 97-118

⁸⁶ Ibid.

⁸⁷ Ibid.

⁸⁸Ostry, S. 'Article X and the Concept of Transparency in the GATT / WTO' in Ostry, Sylvia and Alan S. Alexandroff (ed) *China and Long March to Global Trade: The Accession of China to the World Trade Organization* New York, Routledge 2002, 123

governance and justice.⁸⁹ China's accession to the WTO is understandably both a positive idea and a disruptive catalyst exposing its latent tensions and weaknesses in the face of competitive pressures.⁹⁰ China, with its vast and impoverished interior, wide discrepancies in wealth, and pervasive corruption, is potentially at serious tension.

It is however contended that, in the context of iterative change, both the positive idea and the disruptive catalyst of WTO has transcended into one sequential process. The disruptive catalyst serves as an impetus of broader and deeper economic and legal reforms, while the positive idea serves as a guiding post for such ongoing reform efforts. Most importantly, the accession ensures the open door policy, which is fundamental to the progress and advance of Chinese socialism and its political society at large.

2.3.2.2 Global Rebalance

In the above, global movement is considered an external force in shaping local reforms. In the new era after the global financial crisis of 2008-2009, global capitalisms not necessarily a threat to China as perceived by many scholars. For one reason, the outburst of the recent global financial crisis serves as an alarming bell that a capitalist system has inherent flaws with respect to laissez-faire economic discipline and free market mechanism. At least one scholar has suggested that the so-called "Beijing Consensus" is considered as a potential alternative or supplement to the capitalist system.⁹¹ In any event, the experience of the global financial crisis has prompted for the re-thinking of capitalism. Suffice it to say, the global financial crisis

⁸⁹ Frost, E.L. "China, the WTO, and Globalization: What Happens Next, Peterson Institute for International Economics" in ChinaOnline Website 19 July 2001 [Online]. Available from: <http://www.iie.com/publications/papers/paper.cfm?ResearchID=416> as at 10 January 2010

⁹⁰ Ibid.

⁹¹ Ramo, J.C. *The Beijing Consensus* 2004, pp.11-12

has shown that global economic order based on the Washington Consensus, a United States-led plan for reforming and developing the economics of small and third world countries, is not the only form for global adherence. In this regard, the Beijing Consensus can be a model for other nations around the world who are trying to figure out not simply how to develop their countries, but also how to fit into the international order in a way that allows them to be truly independent, to protect their way of life and political choices in a world with a single massively powerful center of gravity.”⁹² Ramo, who first articulate this idea, suggests that:

*[The Beijing Consensus] replaces the discredited Washington Consensus, an economic theory made famous in the 1990s for its prescriptive, Washington-knows-best approach to telling other nations how to run themselves. The Washington Consensus was a hallmark of end-of-history arrogance; it left a trail of destroyed economies and bad feelings around the globe. China’s new development approach is driven by a desire to have equitable, peaceful high-quality growth, critically speaking; it turns traditional ideas like privatization and free trade on their heads. It is flexible enough that it is barely classifiable as a doctrine. It does not believe in uniform solutions for every situation. It is defined by ruthless willingness to innovate and experiment, by a lively defense of national borders and interests, and by the increasingly thoughtful accumulation of tools of asymmetric power projection. It is pragmatic and ideological at the same time, a reflection of an ancient Chinese philosophical outlook that makes little distinction between theory and practice.*⁹³

⁹² Ibid., p.3

⁹³ Ibid.

While Ramo's assertion of the Beijing Consensus remains to be proven in the longer term, the significance of this observation is that the interplays between global capitalism and Chinese socialism are not a one-way street anymore. That is, Chinese economic reform principles of constant experimentation, that no one plan works for every situation and self-determination can influence economic and political norms of other economic development models of developed and developing nations.⁹⁴

Unlike the Washington Consensus, the Beijing Consensus does not arise from a formal context, and has not been endorsed by other world nations, or even perhaps China itself. Nevertheless, the Beijing Consensus has provided a glimpse of the normative characteristics of China's approach to economic reform in the past three decades, and has served as a reference framework to find evidence of how China's selective adaption of global norms can be fed back to the global scene.

Interestingly, the Beijing Consensus implicitly endorsed the notion of an imperfect society that requires constant self-improving, albeit in an experimentation style. Conceived as such, the Beijing Consensus has application not only to economic developments but also to social and political developments in China. Peerenboom has, for example, expanded the Beijing Consensus into more encompassing views such that China is perceived as a paradigm rested on "six pillars" for developing states.⁹⁵ He labeled the six pillars as: (i) a pragmatic approach in which China resisted attempts of international financial institutions and foreign experts to engage in shock therapy but pursuing instead a more gradual pace of reform; (ii) a non-liberal

⁹⁴ Ibid., pp.11-12

⁹⁵ See Peerenboom, Randall P. *China Modernizes: Threat to the West or Model for the Rest* New York, Oxford University Press 2007, 5

prescription in which China actively intervened in the Chinese economy and played a key role in setting economic policy, establishing functional government institutions, regulating foreign investment, and mitigating the adverse effects of globalization on domestic constituencies; (iii) a pursuit of economic reform before democratization; (iv) a view that universal rights, including human rights, are contingent on local circumstances; (v) a speculation based on neo-authoritarian, new Confucian and communitarian perspectives that China may one day provide a viable normative alternative to the formal democracy and liberalism which have failed to resolve the very pressing issues of social inequality and human well-being for so many people in rich and poor countries; (vi) an emerging foreign relations policy with an importance attached to sovereignty, self-determination, and mutual respect that allows countries to develop on their own terms and in their own ways, freed from the priorities established by the G7 and the conditions imposed by international financial organizations.⁹⁶

The Beijing Consensus and the theory of six pillar paradigm advocated by Ramo and Peerenboom respectively are informal movements where Chinese socialism interplay with the rest of the world. In the aftermath of the global financial crisis of 2008 to 2009, Chinese President Hu Jintao delivered an important speech at the APEC 2008 CEO Summit in Peru, which could have represented China's formal world view at the time. In the speech, Hu advocated a world economic order based on the principles of equity, justice, inclusion, and order⁹⁷ - four core values, based on China's foreign relations policy. In the Third Financial Summit of G-20 Leaders, President Hu Jintao delivered another speech and pointed out that it

⁹⁶ Ibid., p.5-8

⁹⁷ Hu, Jintao "Make Joint Efforts Hand in Hand to Promote Economic Development" [Online], Speech made at the APEC CEO Summit in the Peruvian capital of Lima on 21 November 2008. Available from: <http://in.china-embassy.org/eng/zgbd/t523651.htm>.

would be a top priority for G-20 members to cope with the international financial crisis and to foster healthy recovery of the world economy, as well as to press ahead unswervingly with the reform of the international financial system and realize comprehensive, sustained and balanced development of the world economy.⁹⁸ This speech serves as confirmation by Beijing leaders that China will be reaching out to the global stage on its own terms.

China's renewed engagement into the world scene is a direct consequence of the excessive expansion of global capitalism. First, global capitalism has a tendency to reveal latent tensions and internal weaknesses of less competitive markets while its excessive expansion of globalization has also disclosed its fallacies. Second, global imbalance is identified as one such internal weakness of global capitalism. China's renewed engagement to the world stage is an offence by China to protect its interest from the fallacies of global capitalism as well as a defense by the West to stabilize the world economy through global rebalance. On these points, a member of the Executive Board of European Central Bank, Lorenzo BiniSmaghi, argues that while excessive debt creation and risk mispricing are clearly the root cause of the global crisis, this global crisis is as much a crisis of sellers as of buyers, because in order to make a market there must be buyers and sellers. The build up of excessive demand of easy credit and excessive supply of financial innovation of developed countries are as much to blame as the build up of excessive supply of easy credit and excessive demand of financial innovation of

⁹⁸ Hu, Jintao. "Make Every Effort to Promote Growth and Balanced Development" [Online], Speech made at the Third Financial Summit of G-20 Leaders held in Pittsburgh, the United States on 25 September 2009. Available from: <http://www.mfa.gov.cn/eng/wjb/zzjg/gjs/gjsxw/t616884.htm> as on 14 November 2009.

developing countries.⁹⁹ Smaghi's articulation is based on his observation that three asymmetries exist in the present world system namely financial systems, monetary systems, and macroeconomic policies. By the first asymmetry, it is meant that on the one hand rapid financial innovation and the sophistication of financial products in some mature economies have spurred consumer indebtedness through easy internal and external financing. On the other hand, pervasive financial under-development in some emerging economies has encouraged the recycling of hefty savings and current account surpluses into the financing of ever-growing mature economy deficits. By the second asymmetry, it means that, on the one hand, floating exchange rates have prevailed among mature economy currencies since the collapse of the Bretton Woods system in 1971, a collapse caused by major imbalances in the global economy, and on the other hand, exchange rates have remained heavily managed in emerging economies, notably vis-à-vis the US dollar. Under this system, the U.S. has run large current account deficits, which are the source of export-led growth for other countries, and they in turn have bought up dollars and dollar-denominated assets to fund the U.S. deficit and growing external indebtedness. In particular, there have been significant purchases by these countries of paper issued by U.S. government-sponsored enterprises, which play a key role in U.S. housing markets. By the third asymmetry, macroeconomic policies in some economies have not always been sufficiently focused on medium-term stability and sustainability. This has exacerbated domestic and external imbalances, and ultimately heightened risks to the global economy.

⁹⁹Smaghi, L. B. *The Financial Crisis and Global Imbalances: Two Sides of the Same Coin* Speech delivered at the Asia Europe Economic Forum conference The Global Financial Crisis: Policy choices in Asia and Europe, Beijing on 9 December 2008

In simple words, developing nations' current account surplus, coupled with the expansive role of transnational capital of global capitalism, the build up of excessive debt and financial innovation of the developed countries, and the lack of prudent macroeconomic policies in developed and developing countries have caused global imbalance of economic development in developed and developing countries. In short, global capitalism is one of the several factors that have caused the global imbalance between developed and developing countries.

According to Smaghi, the problem of economic asymmetry is most prevalent in the case of China. In response, the United States has called for international economic cooperation through the G-20 forum.¹⁰⁰ The G-20 forum includes not only major developed nations, such as those already in the G-7¹⁰¹, but also major developing countries such as Brazil, Russia, India, China, Indonesia, and Saudi Arabia. One of the objectives of such global forum is to engage developing and developed countries to address the issue of global rebalancing.¹⁰²

At the Pittsburgh Summit in 2009, G-20 called for a framework for a "strong, sustainable and balanced growth,"¹⁰³ where each G-20 country should primarily be responsible for its own

¹⁰⁰Notes: G20 is made up of the finance ministers and central bank governors of 19 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, United Kingdom and United States of America. The European Union, who is represented by the rotating Council presidency and the European Central Bank, is the 20th member of the G-20.

¹⁰¹ Notes: **G7** is made up of the finance ministers from a group of seven industrialized nations: Canada, France, Germany, Italy, Japan, United Kingdom, and United States. The finance ministers of these countries meet several times a year to discuss economic policies. Their work is supported by regular, functional meetings of officials, including the G7 Finance Deputies.

¹⁰² Notes: this term is used in some literatures to refer to the rebalancing of the global economy away from U.S. demand growth and toward global demand growth. In our context, we take this term to mean the rebalancing of the global imbalance in financial systems, monetary systems and macroeconomic policies. Available from <http://www.aei.org/outlook/26872> (as on 14 November 2009).

¹⁰³ Notes: in the Pittsburgh Summit 2009, the United States proposed a framework for strong, sustainable, and balanced growth. Based on the proposal, G-20 nations pledged to pursue policies aimed at preventing credit and asset price cycles from becoming forces of destabilization and to seek a more balanced pattern of global demand growth. This requires macroeconomic policies that support demand and decisive progress on structural reforms that foster private demand and strengthen long-run growth potential. The G-20 nations also agreed to work

economic management. That is, each country's ability to achieve its goal hinges in part on the actions of others. Therefore, this framework signals a shared recognition among the G-20 that they will need to work together to ensure that the sum of each national policy choices does not result in a return to old habits. Shortly afterwards, the G-20 framework for strong, sustainable and balanced growth was endorsed by the 2009 APEC Singapore Summit.¹⁰⁴ In the statement by the APEC leaders, APEC nations pledged that the global economy could not go back to "growth as usual" or "trade as usual". The world needs a new growth paradigm and a fresh model of economic integration. The APEC nations agreed to pursue growth that is "balanced, inclusive, and sustainable, supported by innovation and a knowledge-based economy". Both G-20 and APEC policies are global initiatives that aim for "global rebalancing".

With the new global initiative of global rebalancing, Chinese economic reform in the post-financial crisis era will play an increasingly important role not only domestically but also globally, albeit remaining evolutionary and incremental, thereby shaping the world economic order in the coming years. For example, China has hastened its pace to internationalize its currency in 2010. It allows its currency, Renminbi, to be used as a settlement currency by its international trading partners. It has also relaxed its restriction to permit Hong Kong, one of its special administrative regions, to develop an offshore financial center in Renminbi.¹⁰⁵ These new currency reform policies are China's economic response to the fallacy of global capitalism.

together to assess how their policies fit together, to evaluate whether they are collectively consistent with the G-20's common goals and, if there are signs of danger, to propose new policies. Available from: <http://www.pittsburghsummit.gov/resources/129664.htm> (as on 14 November 2009).

¹⁰⁴ Notes: the theme of the summit is "A New Growth Paradigm – For a Connected Asia Pacific in the 21st Century. Available from: http://www.apec2009.sg/index.php?option=com_content&view=article&id=310:statement-by-apec-leaders-on-a-new-growth-paradigm-for-a-connected-asia-pacific-in-the-21st-century&catid=39:press-releases&Itemid=127 (as on 14 November 2009).

¹⁰⁵ www.hangseng.com/ermt/eng/fxmv/pdf/ecof_e_2010sep.pdf; accessed at oct 27, 2010.

The response is different from its previous ones as this policy pertains to economic matters outside of its own borders. As and when China continues to internationalize its local economy, it is expected that the interplays between global capitalism and Chinese socialism will intensify. In the aftermath of the global financial crisis, the interplays will conveniently position China at the center of the tension created by the global rebalancing movement.

2.4 Summary

The theoretical framework developed in this chapter consists of three components. The first component is an ideological perspective of socialism. From such perspective, it is seen that socialism is represented by a class of ideologies, all of which aspire to some combinations of socialist and capitalist values along the capitalist-communist ideology spectrum. The second component is an institutional perspective. Specifically, it is a Chinese interpretation of socialism based on its institutional framework. This interpretation conceives Chinese socialism as one particular orientation of socialism along the socialist ideology spectrum. In this interpretation, Chinese socialism is characterized by traditional socialist values such as state control, public ownership, and macro-economic planning, as well as by the local doctrines such as pragmatics and other socialist goals. The interpretation, when based on an institutional perspective, conceives socialism as an evolution of its constituent socialist institutions. In this interpretation, Chinese socialism evolves with the constituent institutions, and the institutions interplay among themselves, including the interplay between local and global institutions such as market system, rule of law and democracy, so does Chinese socialism. The institutional perspective provides a practical view of the evolution and adaptation of socialism in China, as well as a

theoretical basis for the analysis of a long run convergence of the equilibrium state of Chinese socialism. The third component is an iterative theory whereby Chinese institutions are dynamically “advanced” over time in an iterative and normative manner. The iterative theory explains the change process of the socialist institutions in China. A summary of the iterative framework is shown in Figure 1 below. In the iterative model, economic reform is a process whereby each reform causes a small incremental reformation, and based on the outcome of the policy change and the needs of the new circumstances, another policy is articulated for further reform, and so on and so forth.¹⁰⁶ Economic reform is a catalyst of reform for economic institutions as well as legal and socio-political systems in China.¹⁰⁷ I have argued that the converse is also true. That is, legal reform conceived on its own right or shaped by economic reform policy not only changes the legal regime, but also acts as a catalyst for further economic changes. The same can be said about law and politics, and economics and politics.

The overall theoretical framework provides that socialism is an evolving and adaptable ideology, which is shaped by local pragmatics and socialist goals, and is advanced by new conditions such as private ownership and market economy iteratively. Before I conclude this chapter, I should point out that while the Beijing Consensus has suggested that pragmatics are one important successful factor of economic reform, pragmatics does not, in itself, guarantee a progressive reformation of Chinese socialist institutions. In fact, pragmatics may even lead to fallacies due to shortsightedness or compromises. Therefore, the success of the economic reform suggests that the principle of Chinese pragmatics has to be supplemented by other intrinsic normative

¹⁰⁶ Supra Note 52, p.11

¹⁰⁷ See Lubman, Stanley B. *Bird in a Cage: Legal Reform in China After Mao* Stanford, Stanford University Press 1999

forces. I shall explore these normative forces in the following chapters. The iterative framework only explains the process of change, but does not articulate what normative forces advance the changes and how normative forces guide the changes over the long run. Although the pragmatic approach based on the metaphor of crossing rivers by feeling stones depicts a normative principle that suits local conditions,¹⁰⁸ such articulation fails to explain the relations between successive iterations. Most importantly, the pragmatic step-by-step approach fails to explain the self-improving nature that underpins the iterative process of Chinese reforms.

¹⁰⁸ Notes: “Crossing the River by Feeling Each Stone” refer to the pragmatic policy of Deng Xiaoping to move ahead with economic reforms slowly and pragmatically.

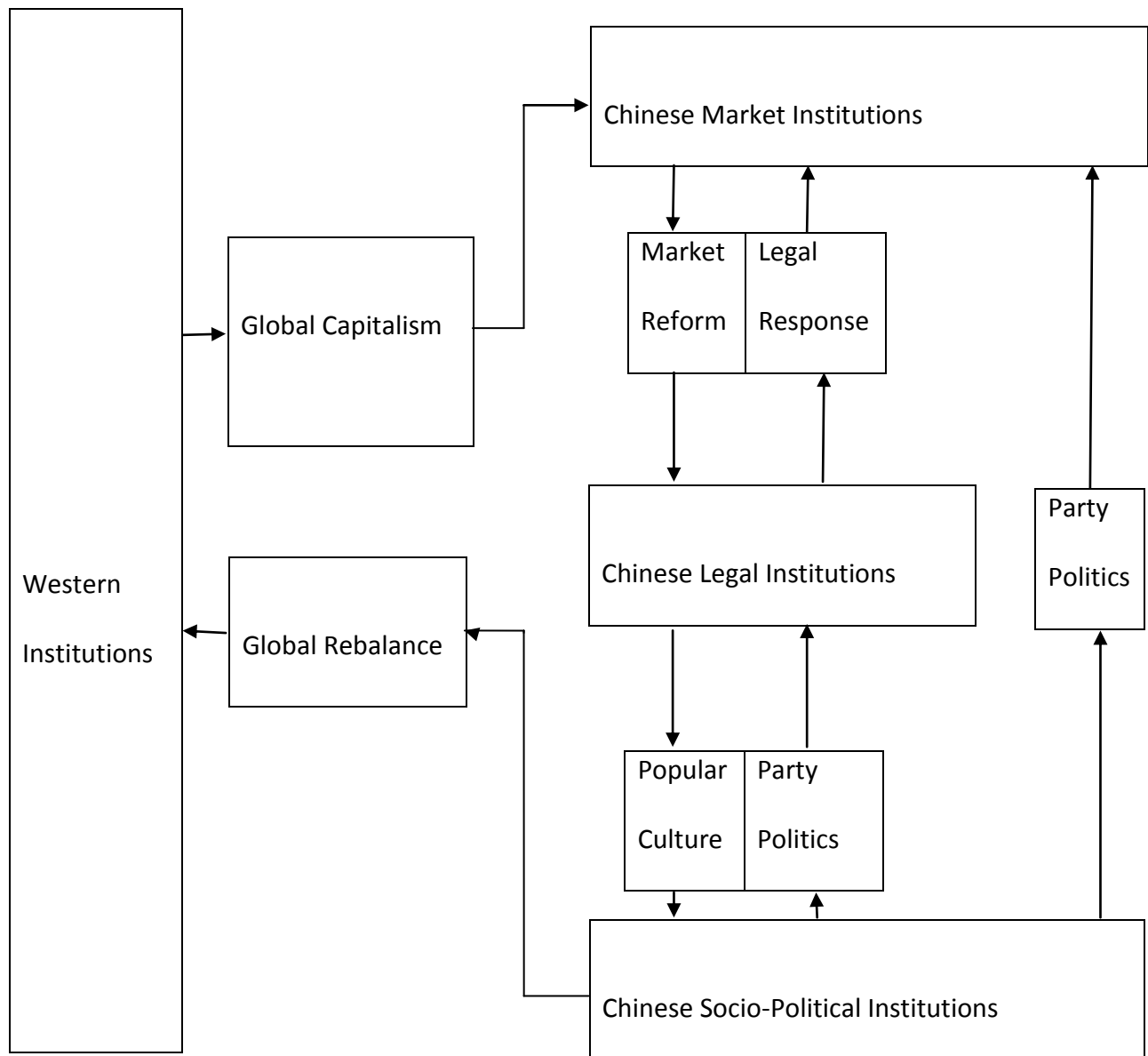


Figure 1 – Integrated Iterative Process of Institutional Changes in the PRC

CHAPTER 3 CAPITAL MARKET REFORM

3.1 Introduction

From the preceding chapter, I argue that the ideology of Chinese socialism evolves with its constituent institutions. Based on that notion, this chapter explores the question - what is the essence of such an evolving ideology? Specifically, this chapter explores the norms that underpin the self-improving iterative process of capital market reforms of the PRC. Through the discovery of these norms, this chapter, and supplemented by the next chapter, provides a historical perspective on the second concept of the thesis, namely what are the local characteristics and how do these local characteristics shape the iterative adaptation of the ideology of socialism to China.

At least one scholar has suggested that there is a widespread conviction among Western China scholars that economic reforms in the PRC over the past 30 years have rendered the ideology obsolete.¹⁰⁹ Such view suggests that China is moving towards or will eventually move towards capitalism and that China will not adhere to socialism indefinitely. In this chapter, it will be shown by way of case studies that the concept of socialism is indeed capable of embodying both capitalist and socialist values. Additionally, it is argued that the mere observation that Chinese ideology has incorporated certain capitalist values does not necessarily imply such ideology is capitalist or is moving towards capitalist per se. Further, I shall argue that the

¹⁰⁹ See Holbig, Heike 'Ideological reform and political legitimacy in China: Challenges in the post-Jiang era' in Heberer, Thomas and Gunter Schubert (ed.) *Regime Legitimacy in Contemporary China: Institutional Change and Stability* London and New York, Routledge 2009, 13

Chinese ideology, albeit evolving, is also intrinsically constituted by certain norms that are not socialist or capitalist in essence. These norms are also important driving force of institutional changes, economic reforms and the evolution of Chinese socialism in China. In any event, it runs the risk of over simplicity by referring to a system as either capitalist or socialist, when the meanings of such terms are themselves evolving and increasingly overlapping.

This case study of capital market reform is primarily based on an institutional approach, which emphasize the role of ideology and local practicality as important factors shaping the process of institutional change. Based on North's theory of institution, Chinese socialism, conceived as a process of institutional change, is shaped by its constituent institutional changes, and at the same time shapes the process of institutional change.¹¹⁰ Accordingly, the iterative framework, as developed in the last chapter, suggests that the process of institutional change is a time series of interplays among these constituent institutions. Ideology, as institutions, is changed through the interplays among these transitional institutions.

Conceived as such, a case study of ideological reform is not about a question of political legitimacy as often suggested by other scholars,¹¹¹ but rather, it is an iterative process whereby the ideology, as constituted by its institutions, is normatively "advanced". That is not to say that all parts of the ideology are changed in the process. I contend that certain basic characteristics of the ideology remain as constant during the change process. In particular, I suggest that self-correction and self-improvement as well as a commitment to pragmatics are some characteristics basic to the Chinese ideology. As such, the evolution of the ideology of

¹¹⁰North, D. *Institution, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press 1990, 76, 111

¹¹¹ Supra Note 101, 15

Chinese socialism is not a threat but an opportunity, even though its evolution may or may not be consistent with the CCP's view of political legitimacy at any particular point in time. In fact, I further argue that CCP's view at any point in time is itself a part of the iterative process and as such is not an absolute concept anyway.

Based on the above formulation, it is not difficult to see that the study of norms is at least as important as the study of the institutional changes or ideological reforms. Since different set of norms will drive different institutions, the essence of the Chinese ideology will comprise of norms from different institutions. I will illustrate my above argument, through normative studies of Chinese socialist institutions, by two case studies - capital market reform and land market reform. Based on these case studies, I will demonstrate how the institutions of capital and land market evolve, and by so doing, to also shed insights into the converging capitalist and socialist characteristics of the Chinese ideology in the long run. In this chapter, I will focus on the case study of capital market reforms. In the next chapter, I will deal with land market reforms accordingly.

Capital market is a core institution of any capitalist market economy. As such it inherently contradicts the socialist nature of China's economic order. Therefore, China's capital market reform is revealing in respect of the sharp tension between capitalist and socialist values over the evolutionary and iterative process of institutional change, as well as between the ideology of socialism, local pragmatics, self improvement culture, and other local conditions. It will also provide insights into the question concerning the ultimate state of the 'socialist' and 'capitalist' characteristics of Chinese ideology.

Interestingly, despite the inherent contradiction of the concept of capital market and socialism, China's 'socialist capital market' has gained both considerable size and significance over the course of economic reforms. It is suggested that China's capital market has displayed a distinct political economy and that such market development has political effects on institutional structure, competition and cooperation patterns, actor constellations, macro-economic resource allocations, etc.¹¹² Most importantly, the institution of capital market inevitably touches on two important reform policies, namely market reform and ownership reform policies. For these reasons, a normative study of China's capital market reform can be viewed as a proxy for the more encompassing socialist ideology.

To conduct the study, I will examine two of the most critical components of Chinese capital market, namely private ownership and market economy. The main interest of the study lies in the self-correcting and self-improving as well as the pragmatic characteristics of capital market development. Hence, in connection with these two institutional components, the following questions are posed: First, what are the norms that are driving these reforms? Second, what are the linkages among their consecutive iterations of changes? Third, what are the political orientations of these norms?

In order to answer these questions, the chapter provides a historical account of capital market reform in the past three decades. Subsequently, the relations between consecutive iterations, based on the historical account, will be discussed and analyzed. Capital market is interesting and relevant in at least two respects. Firstly, its institutional ingredients are closely linked to

¹¹²Schlichting, Svenja 'Internationalizing China's capital markets: Changing actor constellations and emerging transnational professional communities' in Heberer, Thomas and Gunter Schubert (ed.) *Regime Legitimacy in Contemporary China: Institutional Change and Stability* London and New York, Routledge 2009, 153

private property rights and market economy, both of which are defining characteristics of the socialist institutions and thereby the socialist ideology of the PRC. Secondly, capital in its impure form carries with it an ideological concept that shapes the ideology of Chinese socialism. Hence, the reform of 'socialist capital market' in the last three decades, which is consequential to the iterative evolution of the constituting institutions, can serve as a useful guidance for the understanding of Chinese ideology over the long run.

Capital market is not a traditional concept of socialism. This is because capital market is premised on the notion of private ownership and market economy, both of which are not compatible with traditional socialist views. For instance, private ownership is in conflict with the traditional socialist ideology since all production means (i.e. capital) are supposed to be owned by the state or collectively by the whole people, whereas market economy is not compatible with the socialist idea since all economic activities are centrally planned.¹¹³

Notwithstanding, the ideas of private ownership and market economy have been the cornerstone of reform policies in the last three decades of economic reforms of the PRC. It is also noted that at least one scholar has argued that if neither the institutional changes nor socio-economic conditions are favorable to the socio-economic change required for the ownership and market reforms, then such reforms are likely to fail.¹¹⁴ It can be said that these cornerstone reforms which entail socio-economic changes are either bound to fail or will fundamentally change the essence of Chinese socialism in the long term. In this chapter, I shall

¹¹³ See Kornai, Janos *The Socialist System: The Political Economy of Communism* Princeton, Princeton University Press 1992

¹¹⁴ Ho, Peter *Institutions in Transition: Land Ownership, Property Rights, and Social Conflict in China* Oxford, Oxford University Press 2005, 2

argue that the latter will prevail. In this regard, it is my contention that as long as economic reform of the PRC continues, the changing process of the Chinese ideology will inevitably encompass both capitalist and socialist values. Chinese ideology, in its evolving form, will gradually depart from the traditional views of socialism and will advance into a shape that will encompass certain capitalist ideas along with the ideology of socialism due to local pragmatics, the self-improvement culture and other local doctrines and aspirations. In this sense, the continual use of the term 'Chinese socialism' to describe the evolution of the Chinese ideology is a matter of convenience rather than its relative weights between its capitalist and socialist elements. Similarly defined in the last chapter, the concept of 'socialism' is defined broadly to include any political system that meets at least one of the socialist criteria of political system, ownership, coordination mechanism or ideology.

The following is organized into three sections. The first section is about the methodology by which the study of capital market reform will be conducted. There, based on the theoretical framework of the last chapter, I propose an institutional approach to translate the study of capital market into the study of the capital and market institutions. The next two sections are historical events and milestones pertaining to the development of capital and market institutions respectively. These developments will be examined under the context of the normative iterative process. By so doing, I will illustrate the forces that are driving the capital market reform and the relations between these driving forces.

3.2 Analytical Framework

3.2.1 Perspectives of Chinese Capital Market

In China, capital market and its corresponding regulatory regime are developed in tandem in the course of the contemporary economic reforms.¹¹⁵ Capital market reform is also a means towards achieving the goals of the country's economic reforms.¹¹⁶ At the early stages of China's economic reform, capital market reform was not given significant priority.¹¹⁷ Notably, without the emergence of a private sector and a market economy in the mid-1980s, China would not have attained favorable socio-economic conditions to carry out successful capital market reforms.

Typically, Chinese scholars articulated three primary goals for the capital market reforms: fund raising by corporate, an alternative to keeping savings at banks by individuals, and corporate governance of listed companies.¹¹⁸ While these goals are basic functions of capital markets, the unintended consequence of these goals pertain to their closely related concepts of property rights and rule of law from a legal perspective as well as individual liberty and civic society from a social perspective.

Because of these unintended consequences, the development of the capital markets has caused fundamental change to the ideology of Chinese socialism. This change is inevitable as capital does not exist in a vacuum but in an impure form that implicitly carries with it an

¹¹⁵ Wei, Y. The Development of the Securities Market and Regulations in China, 27.3 (2005) *Loyola of Los Angeles International and Comparative Law Review* 480.

¹¹⁶ Ibid.

¹¹⁷ See Wei, Yuwa *Securities Markets and Corporate Governance: A Chinese Experience* Surrey, Ashgate Publishing Company 2009, 11

¹¹⁸ Ibid., p.13 process of

ideological content. Hence, capital market reform has not only achieved the goals of fund raising, alternative investment, and corporate governance of listed companies, but also triggered a socio-political process of institutional change that re-defines Chinese socialism. Two perspectives, local and global, are essential in this respect. In the local perspective, capital market reform is about an empirical study of local changes that are motivated by and rooted to local cultures. In the global dimension, capital market reform transcends into a conceptual analysis that takes into account universal knowledge as well as local culture that distinguishes the reform. On one hand, local perspective is useful because culture shapes law and law shapes culture,¹¹⁹ history is an illustration of culture,¹²⁰ and culture is a source to inform a society of what laws are necessary and appropriate.¹²¹ A local perspective on the historical events of capital market reform can illustrate how law, as a source of popular culture, has evolved over the course of the reform. On another hand, premised on the theory of universal knowledge, where global information flows¹²² and cultural exchanges¹²³ are a predominant force in shaping China's economic reform, the process of institutional change of capital market reform can be conceived as new economic situations that are created by the tensions between global capitalism and the local ideology.¹²⁴ Therefore, a global perspective is also useful

¹¹⁹ See Weber, Max *The Protestant Ethic and the Spirit of Capitalism* Translated by Talcott Parsons with introduction by Anthony Giddens. New York, Charles Scribner's Sons 1976 [1930, c1904-1905] and Howes, David Law as a Source of Popular Culture and Popular Culture as a Source of Law (1995) 10, no. 2 *Canadian Journal of Law and Society* 1-4

¹²⁰ See Geertz, Clifford *Local Knowledge: Further Essays in Interpretative Anthropology* New York, Basic Books 1983

¹²¹ Notes: Law as a source of popular culture means that law is traditionally used to reform popular culture to contain and neutralize perceived threats to the established order. Popular culture as a source of law refers to the function of popular culture as a means to maintain to divert masses and to maintain the established order.

¹²² See Friedland, Lewis A. 'Covering the World' in Lechner, Frank J. and John Boli (ed) *The Globalization Reader* Malden, Blackwell Publishers 2000, p.293-300

¹²³ See Tomlinson, John 'Cultural Imperialism' in *ibid.*, p.307-315

¹²⁴ See Ohmaji, Kenichi 'The End of the Nation State' in *ibid.*, pp. 207-211

because it illustrates how China's local adaptation of socialism to include capitalist ideas is influenced by global movements.¹²⁵

3.2.2 Institutions of Chinese Capital Market

The perspectives described in the previous section addresses the question of 'what' subject is to be studied, but not 'how' the study is to be done. To complete the description of the approach of this case study, I shall outline the 'how' aspect based on an institutional framework.

As said earlier, China's capital market reform can be conceived as a process of institutional change of two of its main constituents, namely capital ownership and market economy. As the notion of capital is encompassing and context dependent, it can mean different things in different situations. From an economic point of view, the notion of capital is associated with a form of wealth used for making profits. In this sense, the notion of capital is more precisely defined as a liquid medium or a mechanism that represents wealth or other styles of capital.¹²⁶ Therefore, the notion of capital comprises of not only physical goods that assist in the production of other goods and services (i.e. real capital), but also notional mediums or mechanisms that represent such physical goods (i.e. financial capital). It follows that capital, conceived as a form of wealth, must therefore be tied to two constructs, namely ownership of capital and a market mechanism that is capable of creation, exchange and dissolution of capital.

¹²⁵ See Potter, P.B. Legal Reforms in China – Institutions, Culture, and Selective Adaptation (Spring 2004) 2, no. 4 *Law & Social Inquiry* 465-495

¹²⁶ Both Werner Sombart and Max Weber located the concept of capital originating in double-entry bookkeeping. Sombart writing in "Medieval and Modern Commercial Enterprise", as quoted on p.38 in *Enterprise and Secular Change: Readings in Economic History*, edited by Lane F.C. and Riemersma J. P., that "the very concept of capital is derived from this way of looking at things; one can say that capital, as a category, did not exist before double-entry bookkeeping. Capital can be defined as that amount of wealth which is used in making profits and which enters into the accounts."

The legal framework of capital ownership, at the very base, consists of two legal concepts: (i) the concept of property rights, and its relation with the concept of ownership rights; and (ii) the concept of legal persons, and its relation with the legal subjects that holds ownership or property rights. In addition, two derived legal concepts can be advocated: (i) the concept of civil relations, markets, and their relations with capital ownership; and (ii) the laws and regulations that provides for the creation, exchange and dissolution of capital ownership.

Generally speaking, capital market can be further distinguished into stock market and bond market. The difference between stock and bond markets can be easily understood from an operational point of view. In a primary market where capital ownership is created, state and individuals can accomplish their financing exercise by selling bonds and/or issuing stocks in exchange for money. Both bonds and stocks are forms of 'securities', which are essentially fungible and negotiable instruments with financial values. Bond markets and stock markets, commonly referred to as 'securities markets' or 'capital markets', serve different functions. Bond markets facilitate the buying and selling of debt securities, whereas stock markets facilitate the buying and selling of equity securities. The main difference between bond and stock securities is that stock securities entitle the holder to own equity in the issuer company and share any profits and dividends distributed by the issuer company or government, whereas bond securities entitle the holder to claim from the issuer company or government to return the principal sum together with interest at a future date to compensate for the loss of use of the capital in that period when the capital is lent to the issuer company or government.

In our context, the significance of the difference between an equity market and a debt market lays in respect to the ideology behind each market. In particular, the ideology underpinning the development of equity markets can be very different from that of debt markets. For a debt market to develop, all that is required are willingness for some individuals, companies, and/or government agencies to borrow and willingness for some others to lend. The borrowing and lending of money concerns with the opportunity cost of use of fund. Consequently, a debt market is compatible with the traditional view of socialism as long as the borrowing and lending activities form an integral part of the centrally planned or approved economic activities. However, for an equity market to develop, the ideology of socialism is required to be “advanced” to embrace the concept of private ownership, in particular, the private ownership of companies. Hence, the development of policies toward capital ownership, particularly private ownership, of a legal person is a pre-condition for the normative development of capital markets in the PRC.

Based on the above perspectives, I shall now proceed to examine capital market’s institutional reforms from both historical and normative angles.

3.3 Capital Ownership Reform

Capital, as a liquid medium, have no intrinsic value unless its ownership is attached with rights to its underlying physical goods. Thus, in the context of capital market reform, the study of capital reform is a study of its ownership right and its related concept of property right. The approach to study capital ownership reform involves a deconstruction of the institutional constituents of capital ownership and a historical examination of the developments of each of

these constituents. In this connection, I propose that, for the purpose of this study, the legal concept of capital ownership shall be constituted by the basic concept of property rights and the concept of legal subjects which hold such property rights.

3.3.1 Property Right

In China, property right is distinguishable from ownership right. Indeed, such distinction in law has been deliberately ambiguous in the early years of the Chinese economic reform,¹²⁷ though subsequent reform policies in the ownership system have evolved towards a framework that allows compatibility between these two concepts.¹²⁸

The historical evolution of the concept of ownership right can be broadly divided into two periods in post-1949 China.¹²⁹ In the first period, from 1949 to 1979, the economy can be labeled as a “socialist planned economy”. During this period, the economy is characterized by an ownership structure constituted by the public. As such, only collective and state sectors exist and virtually no private sector or private economic activities were allowed. Such model is similar to the Soviet-type “command economy”.¹³⁰ In the second period, from 1979 to present, the economy can be labeled as a “socialist market economy”. During this period, the economy is characterized by a transition of the complete public ownership structure to a mixed ownership structure with predominant public ownership coexisting with other economic elements such as cooperative, individual, private, and foreign and joint ventures. During the

¹²⁷ See Keith, Ronald C. and Zhqiu Lin *Law and Justice in China's New Marketplace* Palgrave Macmillan 2001, 139

¹²⁸ Ibid.

¹²⁹ See Guo, S. The Ownership Reform in China: What direction and how far? (2003) 12, no. 36 *The Journal of Contemporary China* 553-573

¹³⁰ See Cheng, Li *Rediscovering China: Dynamics and Dilemmas of Reform* Lanham, Rowman & Littlefield 1997, 53; see also Pei, Minxin *From Reform to Revolution* Cambridge, Harvard University Press 1994, 5

second period, from 1979 to 1987, the state policy is centered on the decentralization of management or an expansion of managerial autonomy of state-owned enterprises. In this period, ownership reform pertains to peripheral changes such as “mandatory planning reduction”, “profit-retention mechanisms”, “profit-tax reform”, and “production responsibility systems” to state-owned enterprises so that these enterprises may operate more autonomously and efficiently.¹³¹

The first major policy change in ownership rights occurred in 1979 when the term ‘operational management rights’ was introduced. The State Council issued the “Regulations concerning the Further Expansion of the Operational and Management Rights of State Enterprise” to confirm the trend towards separating state enterprise from state administration.¹³² The policy did not, in effect, transfer ownership rights of the assets in the state enterprise from the state to the state enterprise. Rather, the policy merely confirmed the state enterprise’s rights to manage and operate these assets with other peripheral rights such as profit retention and production responsibility. While the policy of operational management right is important, this concept is very far from the concept of ownership rights of state enterprises with respect to the assets held by these enterprises. Suffice it to say, while the initial reform of the concept of ownership rights was operational in nature, it was closely tied to an ideological advancement in the prevailing socialist concept of ownership existing at the time in the PRC. The connection between this small, piecemeal, and experimental change concerning operational and management right and the ideological concept, where all production means are owned by the

¹³¹ See Guo, S. The Ownership Reform in China: What direction and how far? (2003) 12, no. 36 *The Journal of Contemporary China* 556.

¹³² See Keith, Ronald C. and Zhqiu Lin *Law and Justice in China’s New Marketplace* Palgrave Macmillan 2001, 140

state, can best be articulated by the following observation. On 27 June 1981, the CCP passed a seminal resolution to repudiate cultural revolutionary radicalism based on the leftist thesis originating in class struggles as the key link.¹³³ The term ‘operational management right’ was then formally incorporated into Article 16 of the 1982 Chinese Constitution and Article 82 of the 1986 General Principles of Civil Law. Surely, without the June 1981 ideological resolution, the new concept of operational and management rights of state assets could not have been written into the Constitution and the General Principle of Civil Law in 1982 and 1986. Though, from a historical perspective, this small and piecemeal step is for all practical purpose largely incomplete and inadequate.

Nevertheless, from an analytical perspective, the economic policy which aimed to improve operational efficiency unintentionally created new tensions in respect of the delineation of legal boundaries of ‘operational management rights’, ‘ownership rights’ and ‘property rights’. The tensions are in large part caused by the incomplete formulation of the concepts and the lack of clarity of the relations between them, which serve as evidence to the assertion that legal institutional changes can often create new economic situations and new tensions associated with these situations. While some scholars conceive these changes as an incomplete reform or drawbacks, it is my contention that the introduction of the incremental advancement of the concepts of operational management rights served as evidence to the assertion that the tensions are the driving forces for continual reforms. Furthermore, this incremental, piecemeal, and experimental step serves as evidence to the pragmatic approach undertaken by Chinese socialist institutions. It is incremental and piecemeal because it only takes a small step to

¹³³ Ibid., p.139

address a small problem pertaining to the operational efficiency of the state sector. Obviously, this is to be contrasted to a big bang approach, which attempts to fix all issues of the state sector in one go. The introduction of the concept of operational management rights is pragmatic, because the new measure merely attempts to strike a balance between limitations imposed by legacy ideology and requirements raised by new circumstances. For instance, the policy of operational management stipulated that these enterprises could retain more operational profits and management autonomy,¹³⁴ and that such enterprises do not have to bear losses.¹³⁵ These policies were further expanded, albeit partially, during the period between 1987 and 1992, to include structural changes to capital ownership including the introduction of a system of contracted managerial responsibility so that powers to manage these enterprises were delegated to managers and directors by contracts with clear responsibilities and benefits to be allocated between the state and the managers.¹³⁶ From a historical perspective, all of the above changes regarding operational management rights, which were instituted in piecemeal and incremental manner over a span of over ten years, were evidence to the assertion that legal development of the ownership right concept is an iterative interplay of economic, legal and socio-political institutions.

More importantly, another observation that can be drawn from the above reform process is its ability to breakthrough traditional ideology barrier of socialist planned economy. In my opinion,

¹³⁴ Notes: The SOE profits increased from 5% in 1979 to 45% in 1987. See Guo, S. The Ownership Reform in China: What direction and how far? (2003) 12, no. 36 *The Journal of Contemporary China* 556.

¹³⁵ See Gao, Shangquan *China's Economic Reform* London, MacMillan Press 1996, pp. 69–70

¹³⁶ See Oi, Jean C. and Andrew Walder *Property Rights and Economic Reform in China* Stanford, Stanford University Press 1999; Also see Perry, Elizabeth J. and Christine Wong *The Political Economy of Reform in Post-Mao China* Cambridge, Council on East Asian Studies 1985

this ability to break traditional ideological boundaries is one important normative virtue of the Chinese local culture. I shall articulate this normative virtue as a 'self-improvement' culture.

Indeed, the economic policy of operational management rights continued to foster and advance the legal concept of ownership rights and property rights. Under Article 71 of the 1986 GPCL, the concept of "ownership rights" was stipulated as being rights to possess, use, benefit from and dispose of one's own property, though no attempt was made to reconcile the concept of "ownership rights" with the operational management rights at the time. The concept of "property rights" was referred in Section 1 of Chapter 5 of the 1986 GPCL, though no attempt was made to clarify the ambiguity of the concept of property rights in relation to the concept of ownership rights. This ambiguity is understandable as the initial step was conceived with the modest goal of dealing with the practical issue of improving the efficiency of state-owned enterprises. Though, in our context, this ambiguity served as the impetus to drive further reform, thereby shaping and at the same time being re-shaped iteratively. The ability to thrive on ambiguities, as argued before, is based on a local culture that constantly seeks self-improvement. In the process, normative virtue of self-improvement and economic goal of efficiency serves as the driving forces that shape legal reforms of operational management rights, ownership rights, and property rights. In this sense, efficiency as a norm that shapes economic institution has caused changes in legal reforms by way of the interplays between economic and legal institutions, even though efficiency itself is not a norm aspired by legal institutions.

The operation management and ownership rights reform then introduced yet another new economic situation whereby state, collective and private enterprises were required to acquire 'legal person' status in order to engage in certain new economic activities.¹³⁷ While the concept of legal person was not an integral part of the ownership system per se, the legal reform of the ownership system, which promoted the concept of legal person, incidentally created a new economic situation. The deficiency and lack of clarity of operational management right, ownership right and property right heightened the tension with the new economic situation, including the need for clarification of the concept of "ownership rights of a legal person". In a 1986 legal conference organized under the auspices of the Shanghai municipal Party organization, and subsequently highlighted in a 1987 law conference hosted by the CASS Institute of Law in Beijing, the concept of the ownership rights of a legal person was discussed, although such notion, as a formal concept, was not developed into the Chinese legal system until much later.¹³⁸

The account of the above events illustrates not only an inter-connection between economic reform and legal reform iterations, but also connections between legal reform iterations within legal institutions of the PRC. In the above example, an economic reform policy that is targeted to improve efficiency and autonomy of state enterprise of the Chinese economy prompted the legal response for 'operational management rights'. The legal response, though peripheral to the ownership structure of the Chinese economy, created subsequent iterations of legal reforms of the concept of ownership and property rights, which in turn created another new

¹³⁷ Article 36-37, GPCL 1983

¹³⁸ See Keith, Ronald C. and Zhqiu Lin *Law and Justice in China's New Marketplace* [city], Palgrave Macmillan 2001, 140

economic situation that called for the need of legal person status. The latter exposed a weakness of the legal regime which then prompted for further reforms of the concept of the ownership rights of a legal person.

The iterations, from the economic reform of operational management right to the legal reform of the ownership rights of a legal person, represent an iterative and normative process. Each iterative step attempts to correct the deficiency of and improve upon the previous one. Together, the iterations constituted a self-improving process.

The above case study shows that the relations between consecutive iteration of economic reform and legal reform illustrated the underlying principle of Chinese pragmatics, and the self-improving characteristics of the iterative process. From an economic institutional point of view, efficiency is a normative force that has been driving the process of capital ownership reform. Such force has the ability to spread from one segment of the socialist system to all parts of the ideology structure. The important corollary is therefore that the process not only has the ability to propagate incremental and experimental changes but also has the tendency to correct drawbacks and improve deficiencies being exposed or created as a result of the process.

Notably, the first formulation of operational management right and ownership right did not touch upon the subject of private ownership. In particular, the state enterprises and the assets owned by these enterprises are considered as both state-owned. In this connection, it is useful to take a discourse concerning the reform of private ownership.

In 1993, the state formulated the landmark policy concerning the establishment of 'socialist market economy with Chinese characteristics'. In this policy, with the advent of a socialist market, it is reckoned that class struggle is no longer relevant but is superseded in a pluralization of interests.¹³⁹ This reform allows and even encourages a non-public sector to develop and foster within the limit prescribed by the state policy. In parallel with this reform, the state attempts to corporatize or restructure the state-owned enterprises into giant conglomerates, shareholding companies or shareholding cooperatives based on the competition of the market while leasing or selling off some small and medium-scaled state-owned enterprises that run losses.¹⁴⁰ This reform includes various measures such as merger, acquisition, leasing, auction, bankruptcy, formation of shareholding companies and joint ventures, all of which supplements the state policy to transform public capital ownership into a mixed public and private ownership structure coexistent in the economy.¹⁴¹ In essence, the 1993 policy created a very important economic situation in respect of the state sector and would unavoidably expose the tensions in respect of the delineation of ownership rights between the state and the corporations. Such policy has far reaching consequence to the legal and political regime as well as the socialist ideology of the PRC. Interestingly, the legal response to the 1993 policy was amazingly gradual, restrained and experimental. In essence, the response was simply to replace the concept of 'planned economy' by the concept of 'socialist market economy' and 'state owned enterprise' with 'state run enterprise',¹⁴² but

¹³⁹ See Keith, Ronald C. and Zhqiu Lin *Law and Justice in China's New Marketplace* [city], Palgrave Macmillan 2001, 140

¹⁴⁰ Shu Y. Ma "The Chinese route to privatization" in *Asian Survey* 38(4) 2008, 382

¹⁴¹ See Guo, S. The Ownership Reform in China: What direction and how far? (2003) 12, no. 36 *The Journal of Contemporary China*, 553-573

¹⁴² Article 7, PRC Constitution, 1993

without elaboration on what exactly these new concepts entail. Similarly, the legal response in respect of ‘property rights of legal person’ which appeared in the 1993 Decision of the 3rd Plenary Session of the 14th National Party Congress was written into Article 4 of the PRC Company Law in the same year,¹⁴³ but initial legal responses which attempted to clarify the concepts of ownership rights and property rights remained in large part ambiguous and incomplete.

The ambiguous and incomplete form of the response could be deliberate as no clear and complete remedial solution was available at the time. And, rather than waiting or delaying in responding, these incremental steps that were introduced with deficiencies served the purpose and provided impetus to drive subsequent iterations of changes. The 1993 introduction of the new concepts of ‘socialist market economy’ and ‘private property right’ prompted the Chinese jurists to search for further clarifications. The search proceeded on two fronts – one looks at the jurisprudence of the civil law tradition and another looks at the nature of these rights and the policy towards the appropriate relation between the state and state enterprise.¹⁴⁴ Notably, the result of the legal research eventually brought about a political response. In 1997, Jiang Zemin, then CCP’s Chief Secretary, addressed the 15th National Party Congress with the directive that state enterprise reform would be premised on further efforts on clarification of property rights, clarification of rights and obligations, and separation of government from enterprise and scientific management.¹⁴⁵ In the premise, the state enterprise reform and the

¹⁴³ See Keith, Ronald C. and Zhqiu Lin *Law and Justice in China’s New Marketplace* [city], Palgrave Macmillan 2001, 140

¹⁴⁴ Ibid., p.143

¹⁴⁵ See Jiang Zemin’s Political Report in *Zhongguogongchandangdisshiwuziquanquodaibiaodahuiwenjianhuibian* 1997 (Compiled Documents of Chinese Communist Party 15th National Party Congress) (Beijing:Renminchubanshe,

emergence of non-public sector brought about new economic situations and promoted the need for legal reforms in relation to the concept of property right. In 1999, the concept of private ownership in which the term 'ownership' includes private possession of the means of production was formally written into the PRC Constitution. In the Constitutional Amendment, effort was made to reconcile the ideological difference between socialism with complete public ownership and socialism with mixed ownership structure by re-stating Chinese socialism was to be in an initial stage of socialism such that the state would adhere to a basic economic system in which public ownership shall be in a dominant position while allowing simultaneous development of non-public ownership economy.¹⁴⁶

On the last point, the iterative process of new economic situations and legal institutional changes has prompted for a political re-statement of the formal notion of Chinese socialism. Specifically, the Chinese ideology has formally embraced an advancement of the ownership structure and an elevation of the importance of private ownership. More importantly, the Chinese ideology was itself also advanced to include the notion that the state shall guide, supervise, and manage the non-public ownership economy,¹⁴⁷ protect the stability and development of the state run enterprise,¹⁴⁸ and protect the lawful rights and interest of non-public economics.¹⁴⁹ In 2004, Chinese socialism was further 'advanced' ideologically where the constitutional status of private ownership was further elevated. In this advancement, the state's role in respect of the development of the non-public sector of the economy was

1997), p.23, cited in See Keith, Ronald C. and Zhqiu Lin *Law and Justice in China's New Marketplace* [city], Palgrave Macmillan 2001, 147

¹⁴⁶ Article 6, PRC Constitution, 1999

¹⁴⁷ Article 16, PRC Constitution, 1999

¹⁴⁸ Article 5, PRC Constitution, 1999

¹⁴⁹ Article 16, PRC Constitution, 1999

changed from guiding, supervising, and managing to that of encouraging, supporting, and guiding.¹⁵⁰ Although the introduction of the concept of private ownership has advanced the notion of socialism in China, it did not entirely clarify the distinction between ownership and property rights. Further legal response was called for. As a result, the concept of private property ownership was formally promulgated by the new property law in 2007.¹⁵¹ The new property law covered all of the three property types within the PRC, specifically state, collective and private.¹⁵² The new property law also divides property rights into three types: ownership rights, use rights, and security rights, thereby concluding that ownership rights are a component of property rights.¹⁵³ The law goes into detail about the legal rights associated with each of these three types to resolve the ambiguity of the concept of ownership rights and to improve the concept of property rights.

In summary, the iterative and evolutionary transformation of the laws of private property rights in socialist China entails an advancement from planned economy to market economy in 1993, to the formal recognition of private ownership in the Chinese socialist economy in 1999, and to the formal clarification of the distinction between ownership and property rights in 2007, which all together illustrate the incremental, piecemeal and pragmatic characteristics of the process of institutional interplays of the PRC. In particular, the principle of Chinese pragmatics has prevailed over the limitation of traditional socialist ideology. The adaptation of private ownership and the advancement of the Chinese ideology are characteristically gradual, incremental and piecemeal. Nevertheless, the process demonstrates a self-correcting and self-

¹⁵⁰ Article 11, PRC Constitution, 2004

¹⁵¹ Notes: China's Property Law was promulgated on 8 March 2007 and effective on 1 October 2007.

¹⁵² Chapter 5, PRC Property Law, 2007

¹⁵³ Article 40, Chapter 4, PRC Property Law, 2007

improvement trend. By doing so, it strives to develop a private sector alongside with a more efficient state sector, all of which are propelled without a pre-conceived grand design at the start.

3.3.2 Legal Person

In the above, it has been mentioned that the reform of the concept of legal person was prompted by the new economic situation of ownership rights and property rights. Though, it must be pointed out that the notion of legal person is not strictly speaking an integral part of the capital ownership system.

China's reform of the ownership rights system, particularly in the context of enterprise ownership rights, has often entailed an element of legal person. In light of the new situation, state, collective and non-state enterprises are required to acquire legal person status to be eligible for engaging in certain economic activities. The historical study of legal person reform serves to illustrate the inter-connection between legal reforms of ownership rights, property rights, and legal persons.

First, according to the Western tradition, a legal person is a concept whereby the law allows a group of natural persons, through a legal entity, to act as if they were a single composite individual for certain purposes, or in some jurisdictions for a single person to have a separate legal personality, other than their own.¹⁵⁴ It is a legal construct created for the purpose of coping with the new economic conditions of the post-industrial revolution where the

¹⁵⁴ Mothersole and Riddley, defines legal personality as a company which is recognized as a person, quite separate from its members [shareholders] As distinct from a natural person. Normally every natural person is also a legal person.

predominant forms of business ventures was changed from sole-proprietorship or partnership to limited liability corporations. The premise of the concept of legal person is that a person is any subject capable of legal rights and duties. Examples of a legal person include companies, partnerships, and limited liabilities companies.

In China, the concept of legal person pre-dated the socialist regime of the PRC. It can be traced as far back as to the Civil Code of the Republic of China in the early twentieth century.¹⁵⁵ The concept of legal person survived the change in power in 1949 when the new communist regime of the PRC abandoned most of the legal systems left by the Republics. In 1950, the concept of legal person was formally adopted in the Temporary Measures Concerning the Conclusion of Contracts Between State Organs, State Enterprises, and Cooperatives (“Measures”) by the new government of the PRC.¹⁵⁶ Article 5 of the Measures stated that a contract or deed must be concluded between legal persons represented by their responsible persons. However, the concept of legal person remained unclear at the time and its development remained sluggish from 1950-1978.¹⁵⁷ The reason for the slow development was that the concept was labeled as a bourgeois legal concept in the socialist command economy.¹⁵⁸ Even in the early stage of economic reform in the early 1980s, the adoption of the concept was restrained and conditional.¹⁵⁹ For example, as the Economic Contract Law of 1981 was developed, the concept of legal person formally employed in the law to a great extent was a matter of convenience,

¹⁵⁵ See Fu, T. Legal Person in China: Essence and Limited (1993) 41, no. 2 *The American Journal of Comparative Law* 262

¹⁵⁶ Adopted by the Financial and Economic Committee under the State Administration Council (predecessor of the State Council) on 27 September 1950.

¹⁵⁷ SeeFu, T. Legal Person in China: Essence and Limited (1993) 41, no. 2 *The American Journal of Comparative Law* 262

¹⁵⁸ Ibid.

¹⁵⁹ See Wang Baoshu& Cui Qingzhi, *JingjiFaxueYanjiuZhongshuSummary of Research on Economic Law* 1989, 72-74

serving for the purpose of defining the capacity of business organizations to be entering into such contracts, rather than as a vehicle for the embodiment of the legal authorities of enterprises to enter into such contracts with independence and autonomy.¹⁶⁰

While the concept of legal person remained ambiguous, it has created new economic opportunities. The new economic situation, acquiring status of a legal person to engage in new economic activities, prompted for academic and public discussion. The concept of legal person rights was further discussed in the conference held by CASS Institute of Law and the Shanghai Municipal Party in 1986.¹⁶¹ The concept, as later codified into the GPCL, provides that a legal person shall be an organization that has capacity for civil rights and conduct, and independently enjoys civil rights and assumes civil obligations in accordance with the law.¹⁶² In fact, the GPCL devoted 18 of the 156 articles for defining the legal framework of legal person. In particular, Article 37 outlines the legal requirements for a legal person as:

- (i) Establishment in accordance with the law;
- (ii) Possession of the necessary property or funds;
- (iii) Possession of its own name, organization and premises, and
- (iv) Ability to independently bear civil liability.

As far as enterprises are concerned, the reform provides that all collective enterprises with the proper qualifications are then able to become legal persons; state enterprises are automatically granted legal personality. Similarly, all sino-foreign equity joint ventures, some sino-foreign

¹⁶⁰ Fu, *Supra* Note 144, pp.263-264

¹⁶¹ Epstein, E. J. *General Principles of Civil Law: Theoretical Controversy in the Drafting Process and Beyond* (1989) 52, no. 2 *Law on Contemporary Problems* 208-9

¹⁶² Article 36, *General Principle of Civil Law of the PRC*, 1983.

cooperative joint ventures, and some wholly foreign owned enterprises are then qualified as Chinese legal persons. Furthermore, official organs, institutions and social organizations which have met the basic requirements are also capable of obtaining legal personality.

One notable deficiency of the above stipulation of legal person rights lay in the concept of ownership rights and/or property rights of the legal person. While legal person was originally conceived as a legal response to inspire autonomy of state enterprises¹⁶³ and as a device to increase the vitality of enterprises,¹⁶⁴ the concept inevitably had to be tied to the concept of the rights attached to the legal person status of these enterprises. This new concept created new opportunities and thereby tensions in the relevant legal institutions, in the sense that enterprises granted with legal personal status are not certain with their respective rights, particularly ownership rights. According to the GPCL, four types of ownership rights of enterprise legal persons are recognized. Firstly, a de facto two-tier property ownership structure exists in respect of collective enterprise legal persons. Both the collective enterprise, as a legal person, and the collective, which established the collective enterprise, are entitled to ownership rights over the property of the collective enterprise. Secondly, foreign investment enterprises as legal persons own their property.¹⁶⁵ Thirdly, for private enterprises that are qualified as legal persons, the law provides that investors of private enterprises shall enjoy ownership rights in respect of the property of the enterprises. Fourthly, state enterprises enjoy

¹⁶³ Tong R, ed., *MinfaYuanli (Civil Law Jurisprudence)* 1983, 51. For an English translation of the most parts of the Second Impression (1987) of this book, see Jones, William C. (ed) *Basic Principles of Civil Law in China* New York, M.E. Sharpe Inc 1989

¹⁶⁴ See Jones, William C. *Basic Principles of Civil Law in China* Armonk, M.E. Sharpe Inc 1989, 65

¹⁶⁵ Article 48 of GPCL 1986

the right to manage the property, but the state shall exclusively enjoy the ownership rights in the state enterprise properties.¹⁶⁶

Obviously, the concept of different ownership rights enjoyed by different legal subjects is far from ideal. For example, one area of tension is related to the implementation of secured transactions for corporate finance, where creditor's protection over the property of the legal persons is paramount. The drawback of the system prompted for a remedial response. Suffice it to say, the initial responses on the subject matter were piecemeal and incremental as different treatment of legal person status remained with different types of enterprises.¹⁶⁷ In particular, ownership rights of various enterprise legal persons becomes non-uniform and unclear, resulting in different ownership rights for different types of legal persons.¹⁶⁸

In the end, the "principle of equal protection" was adopted in the new property law of 2007. Article 4 of the new property law provides that the right *in rem* of the state, collective, individual or any other right holder shall be protected by law, and may not be damaged by any entity or individual. That is, as far as property right is concerned, China has abolished the different treatments of public and private legal persons.

¹⁶⁶ Articles 48 & 82 of GPCL 1986

¹⁶⁷ Notes: Administrative Litigation Law and Civil Procedure Law are examples. In the former, the term "legal person" was employed by the newly promulgated Administrative Litigation Law in 1988. In the latter, the term was not adopted in the trial implementation of the Civil Procedure Law of 1982 but was used in the newly amended Civil Procedure Law in 1991. According to Article 2 of the Administrative Litigation Law, citizens, legal persons and other organizations shall have the right to sue in accordance with the Law if these legal persons think that their legal rights have been infringed by the administrative acts of some administrative organs and their staff. Similarly, Article 3 of the Civil Procedure Law provides that the Law shall apply to civil actions between citizens, between legal persons, between other organizations, and among citizens, legal persons and other organizations.

¹⁶⁸ See Fu, T. Legal Person in China: Essence and Limited (1993) 41, no. 2 *The American Journal of Comparative Law* 283

I shall elaborate the historical development of the 2007 property law of the PRC in the next chapter in more detail. Nevertheless, the current equal protection principle, demonstrated in the context of capital market reform (i.e. equal protection for secured transactions in corporate finance), will create new opportunities and thereby tension in the political society.

Consequently, the value of popular culture of equal subject will prompt for a socio-political response in respect of the social development of a civic society.¹⁶⁹ The implication of this legal and socio-political institutional interplay is particularly important and far-reaching. The reason is that the iterative process of institutional change guided by a local culture of self-improvement will gradually bring about socio-political institutional reforms towards an idea that is consistent with this notion of equal subject. The legal reform of different types of legal persons, in particular the harmonization of property rights of legal persons, will serve as an ingredient to the long process of social and political institutional reforms in the PRC.

3.4 Capital Market Reform

Ownership reform forms one limb of the two pillars of capital market reform. The other limb is, arguably, market reform. Together, ownership and market reforms provide the overall framework of capital market reform.

Indeed, the starting point of a discourse in capital market reform is necessarily an inquiry into the concept of a market system. From a regulatory perspective, a market system can be

¹⁶⁹ See Chen, X. 2009 "Chinese Property Law (Rights in rem) in the Civilian Tradition (2009) 16, no. 2 *Transition Studies Review*, Springer Wien.

conceived as a property rights delineation, transfer and protection system.¹⁷⁰ Such a system depends on an infrastructure that comprises information, accounting services, legal and regulatory services, the judicial system, and other supporting institutions. The infrastructure provides legal protection of property rights by way of three broad categories of institutions and processes, namely for delineation of property rights, for exchange of property rights, and for protection, enforcement, adjudication, and fine-tuning of property rights.¹⁷¹

As such, a capital market system can be conceived as a system of institutions and processes, comprising of: (i) a central registry of property rights and legal and accounting process to define and verify the property rights; (ii) a trading process such as stock exchange trading platform and regulated intermediaries, clearing, settlement and payment infrastructure to facilitate transactions over such trading platform; and (iii) laws, regulations, and norms that protect property rights of all participants, including judiciary and enforcement infrastructures.¹⁷²

It follows that the concept of property rights is situated at the core of the market system, and the concept of property rights infrastructure is a pre-condition for the development of a market economy.

In this dissertation, based on an institutional approach, the concept of property rights infrastructure is conceived as comprising of institutions and processes. As such, the analysis of the market system is a study of its constituent institutions and processes. The study of capital

¹⁷⁰ Sheng A., Xiao G. and Wang Y. 2010. "Property Rights and "Origin Sin" in China: Transaction Costs, Wealth Creation, and Property Rights Infrastructure"[Online], in Stanford Center for International Development (SCID) conference on China's Policy Reform: Progress and Challenges, Stanford University, 14-16 October 2004, p.2 Available from <http://www.sef.hku.hk/~xiaogeng/research/Paper/041008%20PRIOriginalSin-final.pdf>. [Accessed on 1 March 2010]

¹⁷¹ Ibid., p.2

¹⁷² Ibid., p.2

market reform is therefore a discourse in de-construction of the market system into constituent institutions and processes, followed by an examination of each constituent institution and process respectively. In the following sections, I will illustrate how market institutions have and will continue to shape capital market reform and Chinese socialism.

3.4.1 Right Delineation

The notion of property rights, including private ownership, has been dealt with in the last section. Here, I will focus on the exchange of property rights within the context of the market system.

In a capitalistic market system, the notion of property rights assumes recognition of individual private ownership rights. In a socialistic market economy, the assumption that a market economy encompasses private ownership rights and private exchange of ownership rights is not always true. However, the Chinese socialist economy in its own unique way does embody both notions of public and private ownerships. It is therefore possible to study the latter, namely the exchange of private ownership rights, through the institutional developments of the contract law of the PRC.

In the above regard, the starting point is at the time when China transitioned from a planned economy to a market economy at the early stage of the contemporary economic reform of the PRC. Simply put, under a planned economy, economic activities are centrally planned by the state and economic relations were predominantly vertical in nature. Therefore, the role of contract laws pertaining to horizontal civil relations was very limited. Indeed, before the contemporary economic reform, a comprehensive contract law system was hardly developed in

the PRC. It was not until the 1980s, driven by the needs of economic reform, that China's contract law system gradually emerged in a piecemeal fashion.¹⁷³ During those times, different contract laws served for different types of transactions. For example, the Economic Contract Law (1981) served as a basis for domestic transactions while the Foreign Economic Contract Law (1985) was aimed at transactions involving foreigners. Later, the Technology Contracts Law (1987) was created to cover domestic agreements for the sale and licensing of technology. These early developments reflect state imperative to maintain control while recognizing increased autonomy in civil relations in horizontal economic exchanges.¹⁷⁴ Contracts in this period were divided into two categories: civil and economic contracts. Civil contracts basically dealt with consumer transactions, while economic contracts governed transactions related to productive resources. Economic contracts were further divided into domestic economic and foreign economic contracts. Domestic economic contracts reflect certain elements of economic planning and covered economic contracts in which contractual parties were Chinese nationals. In contrast, foreign economic contracts deal with contracts where one of the parties was a foreigner. The significance of this historical context is that China's economic planning is limited to within its national boundary and that international business practice had to be closely monitored. From an institutional perspective, one scholar pointed out that, during the early period of economic reform, China's development of the contract law system reflected an ongoing effort to harmonize norms of freedom of contract with imperatives of state control.¹⁷⁵ The distinction between economic contract and civil contract is therefore a historical

¹⁷³ Potter, P. "The Chinese Legal System: Continuing Commitment to the Primacy of State Power" in *The China Quarterly*, No. 159 (1999) Special Issue: The People's Republic of China after 50 Years, p.679.

¹⁷⁴ Ibid.

¹⁷⁵ Ibid.

phenomenon that denotes the balancing acts among the legal and political institutions of ownership rights exchange in the PRC.

Accordingly, Potter reckoned that the significance of the enactment of the Unified Contract Law (1999) is not as much a phenomenon of legal reform as institutional changes undermined by China's insistence to limit contract autonomy to social and economic well-beings.¹⁷⁶ Though not explicitly stated as such, Potter's articulation can actually be understood through the iterative framework as outlined before. That is, economic policy encouraged foreign investment, which prompted for a legal response to develop civil contract law, and political directive sanctioned state control over vertical oriented planned economy, which demanded status quo. Tension between economic policy and political directive caused legal institution to adopt a piecemeal approach and separated economic and civil contract systems. Later, after much debate, the distinction between domestic and foreign contracts was eliminated and contract law was re-classified as a branch of civil law rather than economic law.¹⁷⁷

The landmark shift is a significant re-interpretation of horizontal economic relations in China. Firstly, the shift is underpinned by a normative re-interpretation whereby economic policy is allowed to iteratively and incrementally shape ideological barriers so that differential treatment between civil contracts and economic contracts, on the one hand, and between domestic economic contracts and foreign economic contracts, on the other hand, are no longer sustainable as China moves towards a market-oriental economy.¹⁷⁸ Secondly, the shift

¹⁷⁶ Ibid.

¹⁷⁷ PRC Contract Law, 1999

¹⁷⁸ Notes: for instance, consider one case where a foreign incorporated company choose to trade with Chinese companies without moving its factory to China. And, consider another case where the foreign company choose to

represents a legal response that demonstrates a normative characteristic in the course of dealing with difficult matters such as unifying disjointed contract law systems and laying the foundation for right-based market systems in China. The normative approach in shaping ideological barriers represented an important normative characteristic of Chinese socialism in that the ideology of Chinese socialism itself opened and was subjected to changes as its constituent institutions were being reformed. Of utmost importance is the phenomenon that the process of changes is not only sequential (within its own institution) but also iterative (between multiple institutions). In all events, the process is incremental and piecemeal. Different solutions are applied to different circumstances even though such piecemeal solution may not sit well within the context of a coherent all-encompassing grand scheme. During the contemporary economic reform, as I shall demonstrate, this phenomenon repeats again and again in all shapes and forms in the iterative process of the socialist institutional reforms of the PRC.

3.4.2 Exchange Platform

In the context of capital market, one kind of exchange platform is known as a stock exchange. It is noted that an exchange of securities take place not only via stock exchanges but also involves a financial industry comprising of financial intermediaries (e.g. banks, securities dealers and brokers).

In this study, I shall focus only on the historical development of stock exchanges.

trade with Chinese companies by setting up a Chinese incorporated company in China through direct foreign investment. In these two cases, no significant differences can be found in the underlying transactions though in the former situation the parties may choose the appropriate law governing their contract.

The earliest reference to the concept of a stock exchange can be traced as far back as to the late Qing dynasty.¹⁷⁹ However, the emergence of a stock exchange platform only came into being some time during the turn of the twentieth century.¹⁸⁰ Under the CCP regime, two new stock exchanges were established, one located in Tianjin in 1949 and another in Beijing in 1950. Both of these stock exchanges however were closed in 1952 when the ideas of the stock market and private ownership were suppressed. The stock market re-emerged some thirty years later.

During the contemporary economic reform of the PRC, the development of a capital market including the development of a stock market can be summarized into three phases. The first phase was the initial stage of development, which started in 1978 and ended in 1990. During this period, in 1981, China resumed the practice of issuing government bonds, though very few individuals were interested. Hence, when the pressure to fund financially stressed state-owned enterprises increased, the government decided to establish a capital market to provide a new channel for financing these enterprises.¹⁸¹ The creation of the capital market can be said as a side product for the needs of China's economic reforms.¹⁸² The development of the stock market and the regulation governing the stock market therefore tracks the needs of the economic reform. In 1983, a company known as the Shenzhen Bo'an County Joint Investment

¹⁷⁹Notes: The earliest reference to a "security" in the history of China relates to the issuance of some kind of treasury bonds by the Qing government in 1867. The first joint stock company, known as the China Merchant Company, was established by the then Minister of Qing Dynasty, Li Hongzhang (李鴻章) in 1872.

¹⁸⁰Notes: in 1891, foreign businessmen set up the first stock exchange, one known as the Shanghai GufenGongsuo (上海股份公所), for trading foreign shares. In 1905, the Qing government converted the Shanghai GufenGongsuo into the Shanghai Stock Exchange (上海眾業公所). Then, in 1914, the first formulation of securities regulation, known as the "Stock Exchange Law", was established by the North Ocean Government (北洋政府). When the North Ocean Government fell and replaced by the Nationalist Government (國民政府), the latter enacted a more comprehensive version of the "Stock Exchange Law" in 1929. But, all of these securities laws and stock market institutions were abolished when CCP took power in 1949.

¹⁸¹ Ibid., p.60

¹⁸² Li, Zhijun, *Government Regulation of the Securities Market* Changchun, Jilin People's Press 2005

Company (now Shenzhen Bo'an Joint Stock Corporation) issued shares to the public for the first time in Chinese socialist history, but securities regulations and stock market institutions were only gradually established afterwards. Even so, the progress of the development of these institutions and regulations was slow, due to close government scrutiny and guidance.¹⁸³ The trading activities were not very active in the initial years of the first phase.

In 1990, two national stock exchanges were established and China's capital market entered into its second phase of development. This period was characterized by the famous "southern tour" of Deng Xiaoping, which took place in 1992. The stock market attracted much attention in this period.¹⁸⁴ Such volatile phenomenon however exposed the inherent weakness of the capital market system and subsequently hastened a formal legal response. In 1998, the first national securities law was enacted. This national law was significant in two respects. One, it served as a formal recognition of the re-emergence of stock markets in modern China, and two, it provided a formal regulatory framework in which the stock exchange platform was required to operate under.

Notably, both the Shenzhen Stock Exchange and the Shanghai Stock Exchange were established in early 1990s, several years before enactment of the national securities law. The initial regulatory response to the newly established stock exchanges was very restrictive, but it nevertheless represented a clear recognition of the ideology of a socialist capital market in China. The socialist characteristic was apparent throughout the first national securities law. For instance, the government introduced new procedures including quota allocation for

¹⁸³ Ibid., p.13

¹⁸⁴ From May 21, 1992 to May 23, 1992, in the span of 3 days, the market index of the Shanghai Stock Exchange went up by 570%.

distributing newly issued shares.¹⁸⁵ The quota control in fact empowered the government to decide which companies' stocks should be admitted into the market. Although theoretically such control would ensure the quality of the listed companies, but because of policy preference, the quota control was in fact exercised to safeguard the interests of state-dominated companies.¹⁸⁶

In addition to these problems, several authors have characterized the pre-2001 socio-economic conditions as immature, segmented and regulatory-driven and emphasized the enduring legacy of the planned economic structure.¹⁸⁷ More importantly, one important characteristic stands out throughout this period, that is, China's capital markets were largely sealed off from foreign entry and investment abroad was equally restricted.¹⁸⁸ The actors of the exchange institutions were mainly securities companies originating from state-owned commercial banks,¹⁸⁹ with fund management companies only emerging after the relaxation of the investment funds business in 1998.¹⁹⁰

Prior to 2001, capital markets had been one of the most shut off sectors of the Chinese economy, in contrast to many other sectors that aimed excessively at utilizing foreign capital,

¹⁸⁵ Ibid., p.14

¹⁸⁶ Ibid., p.14

¹⁸⁷ See Walter, C.E. and F.J.T. Howie *Privatizing China: The Stock Markets and Their Role in Corporate China* Singapore, John Wiley & Sons 2003; Su, D *Chinese Stock Markets: A Research Handbook* Singapore, World Scientific Publishing 2003; Yi, G. *Constructing a Liquid Secondary Bond Market in China. Comments of the Secretary General, Monetary Policy Committee*, PBC, ChinaMoney 2002; Li, Y. and Peng, X. *The Money Market in China: Theory and Practice* China and World Economy 2002, Vol. 3, 3-10

¹⁸⁸ Schlichting, S. Internationalizing China's Capital Markets: Changing actor constellations and emerging transnational professional communities in Heberer, Thomas and Gunter Schubert (ed.) *Regime Legitimacy in Contemporary China: Institutional Change and Stability* London and New York, Routledge 2009, 155

¹⁸⁹ Ibid, 155

¹⁹⁰ CSRC, *China's Securities and Futures Markets* Beijing, China Securities Regulatory Commission 2004

technology and expertise to foster economic reforms under the open door policy.¹⁹¹ This can be attributed to the reluctance and difficulties in reconciling the inherent contradiction of socialist ideology and core institutions of a capital market such as private ownership and market economy. From 2001 to present, however, when the capital market entered into the third phase of adjustment and development, the socio-economic conditions changed considerably.

The above historical development, though often characterized as a failure in effectively achieving the objectives behind such development,¹⁹² serves to illustrate the iterative process of compartmental reforms. In this instance, the stock market reform was not only shaped by the regulatory changes but also social feedbacks. From a market activity point of view, the stock market, in particular, is characterized by drastic ups and downs.¹⁹³ Consequently, one complaint has been that the market has not cured the insider trading problems in state-dominated listed companies, and abuse of the market and misbehavior by listed companies has been widely reported.¹⁹⁴ These problems undermine China's effort to promote sound corporate governance in listed companies and were responsible for the irregular volatility of the capital market.¹⁹⁵ Owing to these problems, Chinese capital market's growth was slow and gradual in the pre-2001 period. But, the internationalization drive of the Chinese capital

¹⁹¹Schlichting, S. Internationalizing China's Capital Markets: Changing actor constellations and emerging transnational professional communities in Heberer, Thomas and Gunter Schubert (ed.) *Regime Legitimacy in Contemporary China: Institutional Change and Stability* London and New York, Routledge 2009, 155

¹⁹²See Wei, Yuwa *Securities Markets and Corporate Governance: A Chinese Experience* Surrey, Ashgate Publishing Limited 2009, 15

¹⁹³ See Xie, B. *China Needs Not to Go with the Tide on the US Securities Market*, available at <http://cn.biz.yahoo.com/070317/16/19c6.html>.

¹⁹⁴Xie, Dai and Xu, *A Comparative Study of US and Chinese Securities Markets*, in BaisanXie (ed.), *International Comparison of Securities Markets* 6, Vol. 1, Beijing, Qinghua University Press 2003

¹⁹⁵ Ibid.

market picked up speed as a consequence of China's accession to the WTO. The open policy enshrined in the WTO entry-related commitments, which include market access for foreign firms mainly through mandatory joint venture structure,¹⁹⁶ caused rapid changes in the landscapes of the capital market of the PRC. Market entry of foreign firms also increased competition against domestic players. In 2001, the Qualified Foreign Institutional Investor Scheme (QFII), a capital market reform, was introduced and opened up the Chinese capital markets for domestic, RMB-denominated shares and bonds to foreign investments. Under this policy, international investment banks, funds management companies, insurance companies, securities companies and commercial banks can apply for QFII status and engage in the intermediation of these transactions under certain restrictive rules.¹⁹⁷ In addition, after WTO entry, the China Securities Regulatory Commission (CSRC) allowed for the set-up of fund management joint ventures with a foreign participation of up to 33 percent of all shares, which was then raised to 49 percent at the end of 2004. A clear timeline for the establishment of controlling majorities in fund management joint ventures is currently still missing.¹⁹⁸ Consequently, at the end of 2003, there were 37 fund management companies in China, of which 13 were sino-foreign joint ventures. By October 2005, the number of fund management joint ventures had risen to 20, as listed on the website of the CSRC.¹⁹⁹

¹⁹⁶ See *WTO Accession of the People's Republic of China* Geneva, World Trade Organization 2001 and *WTO Report of the Working Party on the Accession of CHINA, Addendum: Schedule CLII – The Republic of China, Part II – Schedule of Specific Commitment on Services* Geneva, World Trade Organization 2001

¹⁹⁷ Schlichting, S. *Internationalizing China's Capital Markets: Changing actor constellations and emerging transnational professional communities* in Heberer, Thomas and Gunter Schubert (ed.) *Regime Legitimacy in Contemporary China: Institutional Change and Stability* London and New York, Routledge 2009, 157

¹⁹⁸ *Ibid*, 159

¹⁹⁹ See www.csrc.gov.cn/en/jsp/detail.jsp?infoId=1133922915100&type=CMS.STD, accessed 17 December 2005

From the above phenomenon, it can be seen that the reform of market exchange has demonstrated a self-correction mechanism whereby it adjusts to different prevailing socio-economic conditions. In particular, the market reform was slow and gradual prior to the WTO entry, even though private ownership and other supporting regulatory reform was largely in place. The ideological reform, which was fundamental to this aspect of capital market reform, did not take shape until external forces exerted by WTO accession was formalized. This self-correction mechanism eventually brought about advancement to the capital market developments.

Interestingly, an increasing number of Chinese enterprises now start to operate on an international scale through the domestic capital market. In the aftermath of the global financial crisis between 2008 and 2009, Chinese government has assertively played an even more important role in the coordination of world economic orders through the G-20 forum. In particular, the internationalization of the Chinese currency has taken significant steps since 2010. In June of that year, China liberalized the RMB settlement scheme with international trade partners, a move that was in line with the country's push to slowly internationalize its currency.²⁰⁰ In September of that same year, the State Council approved the General Development Plan for Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone for the joint development of the RMB offshore center between Hong Kong and Shenzhen.²⁰¹

These developments were conceived in the aftermath of the global financial crisis of 2008-2009

²⁰⁰ See www.financeasia.com/news/217991,china-liberalizes-rmb-trade-settlement-scheme , accessed 29 October 2010

²⁰¹ See www.szcpst.com/2010/09/shenzhen-to-unite-with-hong-kong-for-the-rmb-offshore-center accessed 29 October 2010

as part of the effort to demand a paradigm shift in world economic orders. These moves clearly endorsed open policy and internationalization as driving forces of future ongoing capital market reforms. While such economic and political responses in the post global financial crisis era has yet to be played out among the domestic institutions of the PRC, they nevertheless serve as important evidence of the self-corrective and self-improving characteristics of the reform process that is progressively engaging into the international dimension, albeit slowly, gradually, compartmentally, and experimentally, thereby endorsing the internalization application of the iterative theory of socialist institutional change of the PRC.

3.4.3 Rights Protection

3.4.3.1 Securities Regulatory Framework

From a legal perspective, the crux of market development pertains to the rights protection regime of market development. The historical study of the regulatory regime of the Chinese securities market is thereby divided into three stages. The first phase is the period of dispersed, strategic regulation.²⁰² In this period, securities activities and markets are supervised by multiple authorities, including the PBOC, State Council, Ministry of Finance, Securities Regulatory Commission and various local government bodies.²⁰³ As such, the laws governing securities activities were dispersed. The regulatory approach during this period was one law for one matter or one law for one type of securities.²⁰⁴ Securities practice in this phase was a matter of trial and error, and the law was a reactive response to catch up and accommodate

²⁰²See Chen, J. *Special Research on Securities Law* 196 (Beijing: High Education Press).

²⁰³ See Wu H. and W. Hu, *Market Regulation Law: Basic Theory and System of Market Regulation Law Beijing*, Peking University Press 2006, 228

²⁰⁴ See Chen, J. *Special Research on Securities Law* 196 (Beijing: High Education Press), 33.

new market practice and situations.²⁰⁵ In particular, share issuance was subject to the approval system of the quota control, and as such the laws only permitted the enterprises with significant state or public ownership to issue securities. Private owned enterprises were allowed to issue bonds but prohibited from issuing shares to the public.²⁰⁶ In the second phase, from the early 1990s to the late 1990s, when two national stock exchanges were established in Shanghai and Shenzhen, the regulatory focus was typified by fragmented and localized regulation. This is not surprising because, from a historical perspective, regulatory development was constantly lagging behind the market development. While the Chinese government realized the necessity of concentrating the regulatory powers to a single authority, brought about by the establishment of two national stock exchanges, the regulatory function remained in the hands of the China Securities Regulatory Commission (CSRC) and various government departments, including PBOC, State Council's Securities Commission, and the local governments. The operation of centralized stock exchanges and the fragmented regulatory function caused constant tension within the legal institutions during the period. In the third phase, from 1998 to present, the main focus was to catch up on regulatory centralization. In this period, China endeavored to achieve the goal of a centralized regulatory framework. During this period, national legislation gradually replaced local laws. In 1999, a national securities law was formally promulgated whereby all the securities market regulatory functions were consolidated into the CSRC.

²⁰⁵ See Wei, Yuwa *Securities Markets and Corporate Governance: A Chinese Experience* Surrey, Ashgate Publishing Limited 2009, 61

²⁰⁶ Ibid.

The 1999 national securities law illustrates an iterative evolution of economic and regulatory consolidation process. Not only was the national law itself a product of the iterative process, but national law also continued to evolve alongside with the legacy system after its implementation.

To appreciate the intricacy of the parallel phenomenon, it is necessary to understand the jurisprudence of laws, regulations and decrees in China. Firstly, law (法律) has a special meaning in the Chinese legal system. It refers to legislation that are enacted by the NPC (人大委員會) or its Standing Committee (人大常委會). In contrast, administrative regulations (行政法規) refer to legislation that is passed by the executive government, such as the State Council (國務院). Local administrative regulations (地方法規) refer to legislation that is passed by the provincial's People's Congresses. Administrative decrees (行政規章) refer to legislation that is made by the ministries or commissions of the State Council, and local administrative decrees (地方規章) refer to legislation that is made by local executive governments. According to Chinese jurisprudence, law has the highest legal effect and overrides all administrative regulations and local regulations, decrees; administrative regulation overrides local regulations and decrees; local regulation and administrative decree have equal effect; and specialized law overrides general law. Hence, the enactment of the national securities law has the effect of superseding the existing regulations and decrees, insofar as they conflict with the new law. Where the law is silent, however, the existing regulations and decrees remain valid. In effect, the securities regulatory framework was governed by the new national law as well as the

various legacy components - laws, administrative regulations, administrative decrees, and local regulations and decrees.

In terms of the content of the national securities law, its historical development serves to illustrate the piecemeal approach that is typical of the iterative reform process of Chinese socialism. Recall that in the early stage of the reform of ownership structures, different property rights are recognized and attached to different types of legal persons in China.

Accordingly, instead of revamping the entire share ownership structure, the first formulation of the national securities law merely maintained status quo by recognizing three different types of shares in a public listed enterprise, namely (1) state and legal person shares, which are owned either directly or indirectly by the state and which cannot be traded freely on the stock exchanges but can be transferred only with administrative approval; (2) A-shares, which are RMB-denominated and are available for trading by domestic private shareholders on the stock exchanges; and (3) B-shares, which are available for trading by foreign investors in foreign currencies on the stock exchanges.

The fact that the national securities law is built on multiple notions of property rights of legal persons is not satisfactory to say the least. Nevertheless, it reflects succinctly one familiar normative characteristic of Chinese socialism. That is, the distinction of multiple classes of shares is a legal response that represents a compromise of the socialist doctrine of public ownership and the capitalist feature of private ownership of a stock market. This legal response effectively segregated the stock market into three distinct markets – one for each

type of the stocks of listed companies.²⁰⁷ The three distinct markets then created new opportunities for state enterprises, as the notion of public ownership of state enterprises is no longer incompatible with the economic initiative to convert to public listed companies. By going public, these enterprises would be able to access capital markets in China and other oversea jurisdiction, thereby achieving further improvements in operational efficiency and management autonomy.

From an economic point of view, the promulgation of the national securities law helped to improve clarity in the regulatory framework. Indeed, the number of listed companies dramatically increased from 1999 onwards. Statistically, the number of listed companies increased from 182 in 1993 to 851 in 1998, and continued to increase from 949 in 1999 to 1287 in 2003, and reached almost 1400 by the end of 2005.²⁰⁸ Such rapid increase in economic activity created tension to the regulatory regime and exposed its underlying weakness. As a result, further legal reform was called for by the CSRC. First, on the supply side, the large number of enterprises wanting to apply for public listings prompted the CSRC to relax the quota system on IPO issuance in 1999 and abolished the whole system in 2001.²⁰⁹ On the demand side, the strong appetite of Chinese individuals and foreign institutions wanting to participate and benefit from the Chinese shares caused the CSRC to relax the share purchase restriction, including allowing Chinese individuals to buy B-shares in February 2001 and opening the A-

²⁰⁷ Notes: since the Securities Law explicitly refers to the Company Law in some provisions, and both the Securities Law and the Criminal Law stipulates certain market conduct as criminal offences, the Securities Law continues to be cross referenced with these relevant national laws in appropriate circumstances.

²⁰⁸ China Securities and Futures Statistical Yearbook, 1993 - 2005.

²⁰⁹ See Wong, Sonia M. L. China's Stock Market: A Marriage of Capitalism and Socialism (2006) 26, no. 3 *Cato Journal* 398

share market to foreign investors under the QFII in 2002.²¹⁰ In September 1999, institutional investors including SOEs, listed enterprises, investment funds, insurance funds, and pension funds were gradually permitted to invest in the stock market either directly or indirectly through investment vehicles such as investment funds.²¹¹ In February 2000, some selected securities enterprises were allowed to borrow funds from banks with their shares as collateral, thereby marking the first step toward allowing bank credits to enter the stock market. Lastly, in early 2001, the CSCR decided to relax rules concerning the central government's sale of ownership of the listed state enterprises.

Notably, the above example shows how legal institution shapes economic and social institutions and is shaped by its own influence on other institutions. The subsequent reform of the national securities law was in fact prompted by economic and social needs, whereby the central government wanted to respond to the increased social needs on the securities markets, including its own needs to raise funds to replenish its newly established National Social Security Fund (NSSF). The development of the securities regulatory framework is characterized by an incremental, piecemeal and experimental approach based on the principle of pragmatics of Chinese socialism, as exemplified by the following quote of Deng Xiaoping:²¹²

“Are securities and the stock market good or bad? Do they entail any dangers? Are they peculiar to capitalism? Can socialism make use of them? We allow people to reserve their judgment, but we must try these things out. If, after one or two years of

²¹⁰ Ibid.

²¹¹ Ibid.

²¹² Deng Xiaoping was quoted to have made the remark, Editorial Committee for Party Literature, Central Committee of the Communist Party of China 1994, 361

experimentation, they prove feasible, we can expand them. Otherwise, we can put a stop to them and be done with it. We can expand them all at once or gradually, totally, or partially. What is there to be afraid of? So long as we keep this attitude, everything will be all right, and we shall not made any major mistakes”

From the above, the reform of securities law serves to validate the iterative theory of institutional reform in a unique way. That is, as experimentation often brings about uncertainty and volatility of the securities market, CSRC policies reflects a compromise between experimentation and market stability, and illustrates the dynamic interplays among legal, social, and economic institutions. For example, to address market concerns on corporate governance, the CSRC introduced a series of measures aimed at improving corporate governance and legal protection of shareholders in the early 2000s, and suspended the sell-off of the government-owned shares when the market responded with a drastic downturn spurred by fear that the market would be flooded with these shares.²¹³ CSRC took another step to address market concerns on market manipulations and declared 2001 the “year of supervision” and commenced a series of investigation into irregularities and illegitimate activities in the stock market, including illicit use of bank funds for stock speculation, market manipulation, and earning falsification by listed enterprises.²¹⁴ In January 2001, a judicial interpretation was issued by the Supreme People’s Court which stated that fraudulent accounting cases could be pursued in courts by civilians if CSRC had already punished the listed enterprises involved or if

²¹³See Wong, Sonia M. L. China’s Stock Market: A Marriage of Capitalism and Socialism (2006) 26, No. 3, *Cato Journal* 399; See also Green, S. *The Development of China’s Stockmarket , 1984-2002: Equity Politics and Market Institutions* London, Routledge 2004.

²¹⁴See Wong, Sonia M. L. China’s Stock Market: A Marriage of Capitalism and Socialism (2006) 26, No. 3, *Cato Journal* 399;

criminal proceedings had already taken place, thereby introducing the possibility of civil actions against China's listed enterprises by its shareholders.²¹⁵ The above sequence of events illustrates an iterative process of legal reforms which not only respond to stock market development based on the spirit of local pragmatics, but also balance it against the goals of social stability, market fairness and transaction equity.

Furthermore, after the WTO accession, between 2001 and 2003, the capital market was developing very rapidly. The legal responses to these market developments were made through various measures and judicial interpretation. The number and extent of such responses practically made the national securities law of 1999 out-of-date even though the law was enacted only a few years back, thereby prompting a major revision to the law at the Eighteenth Session of the Standing Committee of the Tenth National People's Congress of the PRC on 27 October 2005.²¹⁶

The 2005 revision of the new securities law of the PRC contained many characteristics of the Western markets. Firstly, with regard to the segmentation of financial services and markets, under Article 6 of the old Securities Law, securities business must be engaged in and administered as a business separate from the banking business, trust business and insurance business. The reason behind this structural constraint is the excessive concentration of economic power and conflicts of interests inherent in multi-service financial groups. However, in practice, the distinction between different types of financial institutions – banks, securities

²¹⁵ See Li, C.T., F. M. Song and S. M. L. Wong, "Audit Firm Size Effects in China's Emerging Audit Market" University of Hong Kong, Hong Kong Institute of Economics and Business Strategy Working Paper Series, No. 1114.

²¹⁶ The New Securities Law of the PRC, 2005

firms and insurance companies – are becoming increasingly blurred.²¹⁷ In China, the local reality is that some banks are becoming increasingly involved in asset management and broker-dealer activities, and similarly insurance companies are entering into the business of securities markets. In response to these new economic conditions, Article 6 of the new securities law grants the State Council the power to remove the structural constraints when it is necessary. This is similar to the U.S. Gramm-Leach-Bliley Act of 1999, which partly repealed the Glass-Steagall Act, an Act that allowed financial holding companies the ability to engage in unlimited securities activities. With regard to the structure of the securities market, under the old regime, securities trading must take the form of spot transaction. This effectively precluded the development of financial derivatives such as securities futures and options, which contravened with China's WTO commitment to fully open its financial markets by the end of 2006. The new securities law permits securities transaction to be carried out in the form of spot goods, or any other form prescribed by the State Council, opening the door for the development of financial derivatives in China. With regard to the establishment of multi-level securities markets, under the old securities law, all shares, corporate bonds and other securities that have been lawfully approved for trading had to be quoted and traded only on the stock exchanges. This effectively prohibited the existence of other forms of securities markets such as the over-the-counter (OTC) market, and undermined small and medium enterprises, since they could not meet the stringent listing requirements in order to access the capital market. To address this shortcoming, the new securities law permits securities to be traded in stock exchanges or in any other places approved by the State Council. Thirdly, with regard to investor protection, Article

²¹⁷ See Australian Department of Treasury, 2005. "Financial System Inquiry: Final Report (1997)" [Online]. Available from <http://fsi.treasury.gov.au/content/publications.asp>. [Accessed on 23 December 2005].

68 of the new securities law takes an approach that is similar to the US model of the Sarbanes-Oxley Act, by making it mandatory for directors and senior managers of listed companies to provide their opinions in the periodic reports of their companies and guarantee the authenticity, accuracy and integrity of the information as disclosed in these reports. The new securities law also expands the notion of material information in connection with the requirement of continuous information disclosure,²¹⁸ and the scope of the insiders in relation to the prohibition of insider trading activities²¹⁹. For the first time, the new securities law introduced a securities investor protection fund, which will be used to compensate innocent investors harmed by market misconduct.²²⁰ Finally, with regard to the efficacy of the regulatory regime, the new securities law provides the regulators more powers to perform their duties, conferring on the regulators a wide range of powers, including investigative and information gathering powers and corporate asset preservation powers.²²¹

While the enactment of the national securities law of 1999 represents a landmark change to capital markets in China, the series of advancements in market activities from 2000 to 2005, which antiquated that particular version of the national law in a few years time, has prompted for the newly promulgated securities law of 2006. The new law reflects the issues common to China and the West such as cross-activities in banking, securities, asset management and insurance, market misconducts, continuous information disclosure requirements, etc. The Chinese approach also reflects a cautious attitude by maintaining the discretion to the regulatory authorities to decide if and when additional steps are to be adopted to address

²¹⁸ Article 67, PRC Securities Law, 1999

²¹⁹ Article 74, PRC Securities Law, 1999

²²⁰ Article 134, PRC Securities Law, 1999

²²¹ Article 180, PRC Securities Law, 1999

those issues. Such legal response represents a pragmatic attitude and an incremental, piecemeal and experimental approach, with an increasingly important international dimension, to cope with uncertainties arising from the rapid emergence of stock market developments in modern China.

3.4.3.3 Mergers and Acquisitions

The national securities law provides a core framework of property right protection for the Chinese capital market in the early stage of economic development. However, as market reform continues, the core framework needed to expand to deal with new situations. Two aspects, namely mergers and acquisitions and corporate insolvency, though absent from the early operation of capital markets in China, gradually emerged in post-2001, years of the economic reform.

From an economic perspective, mergers and acquisitions (M&A) are corporate restructuring techniques. In a merger, two or more companies are combined into one company by agreement. Under this situation, only one company will remain in existence after the merger.²²² In an acquisition, one company obtains controlling power of another company by acquiring a certain percentage of shares of that company. Under that situation, one company acquires a substantial control over another company with the two independent economic entities co-existing. In the context of economic reform, especially in respect of the open door policy, M&A activities are mostly concerned with foreign direct investment (FDI), in the form of asset and equity acquisition as well as mergers of the acquisition vehicles. Since China has

²²²Gu, Minkang *Understanding Chinese Company Law* Hong Kong, Hong Kong University Press 2006, 245.

become one of the world leading destinations of foreign direct investment (FDI) during economic reform, M&A regulations forms an integral part of the property right protection regime of the capital markets in China.

At the early stage of the economic reform, the open door policy, in respect of foreign trade and investment, was limited to the so-called green field investments²²³. As such, foreign investors entered into the Chinese market by way of foreign-invested enterprises (FIEs)²²⁴. However, since FIEs were prohibited from capital-raising measures such as bond issuance and initial public offerings, FDI inflows were not able to tap into the Chinese capital market. In this context, China promulgated a series of laws and regulations in respect of the foreign investment activities. As foreign investors could not directly operate businesses except through FIEs in China, the legal reform of FIEs became a proxy for the initial design and operation of the development of M&A legal framework in China.

In the initial stage, four types of FIEs were allowed in China: (1) sino-foreign equity joint venture, (2) sino-foreign cooperative joint ventures, (3) wholly foreign-owned enterprises and (4) foreign investment enterprises limited by shares. Further, foreign investor's investment projects are classified by industry sectors, stipulated in the "Catalogue for the Guidance of Foreign Investment" ("Catalogue") as "encouraged", "permitted", "restricted" or "prohibited". The catalogue classification affects the approval process and the permissible foreign equity

²²³ Notes: A green field investment is the investment in a manufacturing, office, or other physical company-related structure or group of structures in an area where no previous facilities exist. Green field investing is usually offered as an alternative to another form of investment, such as mergers and acquisitions, joint ventures, or licensing agreements.

²²⁴ Notes: FIEs provided employment to many millions of employees much of them embodied with technological and management skill transfers. As of 2003, FIEs accounted for half of China's two-way merchandise trade.

holding. Arguably, the above framework is a regulatory framework of foreign investment. It is not a M&A legal framework, as it does not specifically address M&A transactions.

Statistically, M&A transactions were insignificant in China before the turn of the century.²²⁵ In spite of that, according to the 2003 OECD Investment Policy Review Report, China's accession to the WTO in 2001 brought forth a major advance in China's FDI policy, which not only removed trade-related investment measures but also opened its service sectors, including the financial and foreign trade sector.²²⁶ Such advancement in FDI policy has attracted cross-border M&A activities. As market reform in the foreign trade and investment sector deepened, the appetite of foreign investors to enter into the Chinese market through mergers or acquisitions of existing facilities or domestic enterprises increased. As such, the FIE legal framework proved to be inadequate for the then economic situations. In 2003, the M&A legal framework was primarily governed by the "Tentative Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors"²²⁷ ("M&A Rule"). The M&A Rule classified mergers and acquisitions of domestic enterprises by foreign investors as equity M&A and asset M&A. However, such classification was a response to economic reality, rather than the ideas of legal design, and the M&A Rule was found to be inadequate and cumbersome in coping with the increasingly sophisticated M&A transactions.

In 2006, the tentative M&A Rule then underwent a clarifying overhaul, which resolved some inconsistencies in the prior regulations. Six Chinese ministries promulgated the amended M&A

²²⁵ Webre, E. 'Mergers and Acquisitions in China' in *Deacons Law Firm Bulletin*, 29 January 2005. Available from: http://www.deacons.com.hk/eng/knowledge/knowledge_212.htm

²²⁶ OECD Investment Policy Reviews, China: Progress and Reform Challenges 2003, p.15.

²²⁷ Promulgated on 7 March 2003.

Rule on August 8, 2006, which became effective on September 8, 2006 ("New M&A Rule"). This New M&A Rule improved the old rules by incorporating new provisions. It expounded the formal requirement for share-swap transactions, extended the scope of anti-monopoly review, and streamlined the regulatory forces on round-trip investment that is commonly used in venture capital transactions aiming for an overseas listing of China-bounded operations. Nevertheless, M&A transactions continued to be subjected to specific approvals under the New M&A Rule. That is, as a general matter, transactions involving encouraged or permitted projects with a total investment amount of US\$100 million or more, or restricted projects with a total investment amount of US\$50 million or more, typically required the approval of the Ministry of Commerce (MOC) and State Development and Reform Commission (SDRC). Otherwise, M&A transaction could be approved by the Ministries' provincial or lower level branches. Additionally, as mentioned in the previous section, most shares in China were not freely transferable, since listed A shares could only be held by PRC nationals, listed B shares could only be held by foreign nationals, and state-owned shares could only be held directly by the State or government entities. Hence, M&A transactions involving listed companies were subject to separate regulations based on share classification.

The various regulations governing the various types of shares have caused limitations and complications in the development of the capital market in China. Essentially, each share category was a separate capital market of its own. Market participants could not freely move capital from one market to another. This limitation prompted for an economic policy and an improved legal framework so that the convergence of the different share classes could be achieved.

Indeed, the process of convergence of different share classes is underway. Similar to other past reform policies, the Chinese regulators have adopted a piecemeal, incremental approach. In 2008, the Administrative Measures on the Acquisition of Listed Companies was amended to provide a framework for the acquisition of listed companies by foreign investors, which was applicable to acquisitions of over 30% of the outstanding shares of a listed company. Previously, in respect of the listed shares, the A-share restrictions precluded foreign parties from making tender offers, but pursuant to the Interim Provisions on the Administration of Security and Investment in China by Qualified Foreign Institutional Investors (“QFII”), a qualified foreign institutional investor is permitted to hold up to 10% interest in the A-shares of any particular listed company, with the combined QFII holding not to exceed 20% in any company²²⁸. In 2006, pursuant to the Administrative Measure on the Strategic Investment in Listed Companies by Foreign Investor Procedures, the A-share market was opened to non-financial investors allowing strategic investors, meeting certain criteria, to acquire A-shares. The strategic investor regulation requires a minimum acquisition of 10% and does not limit the percentage of A-shares that may be acquired. The acquisition of a controlling stake is thus possible. But, only listed companies that have undergone the share reform process for converting non-tradable shares into tradable shares are eligible to receive such investment. The regulations explicitly require consideration of anti-trust related issues in screening strategic investor candidates. It is therefore expected that the A-share market will further open to foreign investment.

²²⁸Webre, E. ‘Mergers and Acquisitions in China’ in *Deacons Law Firm Bulletin*, 29 January 2005. Available from: http://www.deacons.com.hk/eng/knowledge/knowledge_212.htm

In respect of the non-listed shares, previously foreign acquisition of legal person shares in listed companies was prohibited at the early stage of the market reform. In 2003, the restriction was lifted, pursuant to the Notice on Relevant Issues Regarding the Transfer of State-Owned Shares and Legal Person Shares of Listed Companies to Foreign Investors. The Notice outlines a regulatory framework for the transfer of non-listed shares to foreign investors, whereby the foreign investor must satisfy certain investor qualifications. Such shares are also subject to a lock up period. The target company will also have to convert into an FIE and will not enjoy the benefits typically available to FIEs as a result.

In summary, the initial policy of open door policy has attracted foreign investors, and the initial regulatory framework based on the FIE framework has prompted investors to only engage in green field investment in China. Sophisticated cross-border investment activities increase as FDI inflows grow due to the initial framework. As a result, the M&A segment of the capital market eventually emerge. The new M&A activities prompted for a more vigorous legal regime, which entailed revamping the overall share classification scheme of the Chinese capital market. This share reform process touches upon the notion of private ownership and requires a normalization of different rights attached to different class of shares. And while such normalization is still in its early stages, it can be observed from the above historical phenomenon that the reform process has been piecemeal and ad-hoc, focusing on areas where the needs are pressing. Such process is typical of the past reform process. What is important, however, is that the normative characteristic underlying capital market reform can override ideological barriers. In this respect, the normative values such as self-correction and self-

improvement, as well as local pragmatics and openness will eventually trump traditional socialist ideologies in shaping future M&A law reforms.

3.4.3.4 Bankruptcy System

Bankruptcy system is another new development that, though peripheral to the operation of capital markets, has a profound effect on the protection of property rights. In the context of Chinese socialism, the Chinese bankruptcy system represents an ongoing effort to balance the imperative of socialist values against property rights protection.

Generally speaking, bankruptcy systems reflect the legal, historical, political and cultural context of the countries that have developed them.²²⁹ In the context of capital markets, bankruptcy system reflects how philosophically countries have viewed equity and debt.²³⁰ In China, corporate bankruptcy system, conceived as a social tool, reflects how the Chinese socialist regime responds to the financial failure of companies and individuals associated with a credit-based economy.

In traditional Chinese society, the concept of personal bankruptcy was not recognized because its legal and ethical tradition was based on the norm that “the son pays for the debts of his father”²³¹. Hence, bankruptcy system has little room to play in a traditional Chinese society. The emergence of a bankruptcy system in China represents that such tradition has changed

²²⁹ See Martin, N. “Common Law Bankruptcy Systems: Similarities and Differences” in AM. Banker, Inst. L. Rev. 11, 367 (2003) 403-10.

²³⁰ Martin, Nathalie, “The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation” in *Boston College International and Comparative Law Review*, Vol. 28, No. 2 (2005) p.5. Available from: <http://ssrn.com/abstract=1444531>

²³¹ Li, S. “Bankruptcy Law in China: Lessons of the Past Twelve Years” [Online]. Harvard Asia Quarterly, Harvard University, 1: Vol. 5 (2001). Available from: <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>

with economic reform. In fact, in a culture that allows or encourages the proliferation of credits as a means to promote economic growth, such as a capitalist economy, the bankruptcy system has an important role to play. Therefore, the development of a bankruptcy system is illustrative of how tradition has changed, and how the norm has been transformed by the capital market reform.

Culture plays a substantial role in Chinese bankruptcy laws²³². As ideology has a great effect on attitudes and culture, socialism is therefore key to the resulting bankruptcy laws.²³³ Prior to the economic reform, all enterprises were state-owned and as such were not subjected to bankruptcy, even though some of these state-owned enterprises suffered substantial losses. Indeed, state-owned enterprises are property of the state and therefore bankruptcy is viewed as a leadership failure and a loss of face for the government.²³⁴ During this intervening period, the Chinese government practiced a uniform policy of centralized assumption of profits and losses of state-owned enterprises (SOEs) under the planned economic system. In 1986, the trial bankruptcy law was introduced under the CCP regime. Notwithstanding that it was only a trial version, the drafting and legislative process of the trial law had been under furious debate. Arguments against the trial law were, for instance, social instability and spillover effect in the financial sector.²³⁵ The trial law, deficient in many details, represents a half way approach to meet the needs of economic reform. For one, the trial law leaves the decision about whether

²³² Martin, Nathalie, "The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation" in *Boston College International and Comparative Law Review*, Vol. 28, No. 2 (2005) p.71-72. Available from: <http://ssrn.com/abstract=1444531>

²³³ Ibid., p.73.

²³⁴ Ma, P. "A New Chinese Bankruptcy System: Made for the Business or for the State" in *Austl. Corp. L.*, 11, 192 (2000) 205.

²³⁵ Wu, W. "Commencement of Bankruptcy Proceedings in China: Key Issues in the Proposed New Enterprise Bankruptcy and Reorganisation Law" in *University of Wellington Law Review*, Victoria, University of Wellington, Vol.35 (2004)

or not a company can file for bankruptcy in the hands of the government, rather than the courts or creditors. For another, the trial law was only applicable to state-owned enterprises. Under the law, state-owned enterprises required governmental approval so that employees and existing assets could be resettled before bankruptcy could occur. These shortcomings were addressed at the fourth session of the seventh national people's congress,²³⁶ whereby the NPC issued an amendment to Chapter 19 of the Code of Civil Procedure. Unlike the trial law, Chapter 19 is applicable to all forms of entities that have a legal person status. Specifically, Chapter 19 discussed bankruptcy for non-state-owned enterprises²³⁷, specified repayment procedure,²³⁸ provided a three-month period for creditors to file claims in the People's Courts,²³⁹ and established priorities for repayments: (i) wages of employees and labour insurances, (ii) unpaid taxes, and finally (iii) bankruptcy claims.²⁴⁰

However, the trial law was largely inadequate to meet the needs of the economic situation, as the Supreme People's Court had to issue supplemental interpretations to address certain inconsistencies.²⁴¹ These adjustments to the trial bankruptcy law led to the addition of some articles to the Chinese Company Law in 1993. In addition, the provincial governments of the special economic zones of the Guangdong and Shenzhen provinces released their regulations

²³⁶ Held on 9th April 1991.

²³⁷ Article 199-206, Civil Procedure of the PRC, 1991 (amended 2007)

²³⁸ Article 199, Civil Procedure of the PRC, 1991 (amended 2007)

²³⁹ Article 200, Civil Procedure of the PRC, 1991 (amended 2007)

²⁴⁰ Article 204, Civil Procedure of the PRC, 1991 (amended 2007)

²⁴¹ Neelen, U.Bankruptcy and Intellectual Property in the PRC, LLM Thesis, Murdoch University (2009), [Online].Available from: <http://wwwlib.murdoch.edu.au/adt/pubfiles/adt-MU20070820.144651/02Whole.pdf>. [Accessed on 29 January 2009]

on company bankruptcies.²⁴² Further, measures on liquidation procedures for foreign investment enterprises were introduced in 1996.²⁴³

The problems of the national trial bankruptcy law were further complicated by its inconsistencies with a number of regional insolvency systems. Although, Chinese jurisprudence dictates that where local regulations conflict with national laws, the latter will prevail, in practice, the outcome can still be inconsistent. Liquidation Group of Wenzhou Trust Company v. Xinfu Industrial Co. Ltd. (3/21/00), the Higher People's Court of Hubei Province, and on appeal to the Supreme People's Court (7/18/02), demonstrated a need to protect creditors' rights. A year later, in 2003, the Higher People's Court of Guangdong Province, construed the 1986 Trial Law strictly and placed the creditor's group in the lowest priority bracket, resulting in minimal recovery for the creditors. This inconsistent approach adopted by the courts at different levels demonstrated the need for further bankruptcy reform.

Similar to the reform of securities regulation, the reform of bankruptcy law was influenced by China's open door policy. For instance, while China's policy towards bankruptcy of state-owned enterprises reflects the traditional role of such enterprises as a socialist institution, offering lifetime employee welfare protection was not entirely compatible with its accession to the World Trade Organization in 2001. In order to be declared as a market economy under the accession terms, China had to address the issue of its implementation of a structured bankruptcy law system. In this respect, several areas in the bankruptcy system are especially problematic. Firstly, Article 3 of the 1986 trial bankruptcy law provides that "enterprises for

²⁴² Li, S. "Bankruptcy Law in China: Lessons of the Past Twelve Years" [Online]. Harvard Asia Quarterly, Harvard University, 1: Vol. 5 (2001). Available from: <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>

²⁴³ Neelen, Supra Note 233

which creditors file for bankruptcy shall not be declared bankruptcy under any of the following circumstances:

1. Public utility enterprises and enterprises that have an important relationship to the national economy and the people's livelihood, for which the relevant government departments grant subsidies or adopt other measures to assist the repayment of debts;
2. Enterprises that have obtained guarantee for the repayment of debts within six months from the date of the application for bankruptcy."

The above provision effectively makes bankruptcy subject to government discretion, as the meaning of "important relationship" and "people's livelihood" is subject to government interpretation, and whether or not to grant assistance to repay debts is subject to government decision. Secondly, Article 17 of the 1986 trial law states, "with respect to enterprises for which creditors file for bankruptcy, bankruptcy proceedings shall be suspended if the enterprise's superior department in charge have applied for reorganization and if the enterprise and its creditors have reached a settlement agreement through consultation." This effectively gives the bankrupt's department in charge the ability to fashion a re-organization, and thereby delay bankruptcy proceedings for two years.²⁴⁴ Thirdly, Article 4 specifically places the burden on the state to take care the employees of bankrupt state-owned enterprises, as it provides that, "the state through various means shall arrange for the appropriate reemployment of the staff and workers of bankrupt enterprises and shall guarantee their basic living needs prior to reemployment".

²⁴⁴Tomasic, Roman A. and Margaret Wang 'The Long March towards China's New Bankruptcy Law' in Tomasic, R. (ed.) *Insolvency Law in East Asia* Aldershot, UK, Ashgate Publishing Limited 2009, 99-100. Available from: SSRN: <http://ssrn.com/abstract=1433730>

The tensions evinced in the above areas showed that socialist goals continued to play an important role in guiding bankruptcy law reforms. The trial law is a legal response to social considerations of bankruptcy and its impact on the China's financial system if those enterprises were bankrupt.²⁴⁵ As a result of China's accession to the WTO, namely the call for a market-oriented bankruptcy system, a new economic situation arose and it prompted the drafting and enactment of a new bankruptcy law.²⁴⁶ Accordingly, it is contended that the historical study of the new law is illustrative of the Chinese government's attempts to shift bankruptcy towards a more market-oriented policy. Further, the study shows that this legal response to China's desire to compete in the global capital market has indeed resulted in the adaptation of several legal reform policies that are representative of Western bankruptcy laws. Specifically, the new bankruptcy law expanded the scope and includes legal corporate persons, encompassing not only state-owned enterprises, but also private and public companies, whether foreign or domestic, and to a certain extent it is applicable to financial institutions as well. The new law also seeks to protect creditors' rights as well as workers' rights. The legislation not only allows creditors to take actions against debtors and companies that are unwilling to file for bankruptcy, it also limits State intervention in bankruptcies of state-owned companies. Another improvement is the ability of companies or enterprises in financial difficulty to reorganize, restructure and rectify their financial problems prior to filing for bankruptcy (Art. 73). Another policy reform was that previous bankruptcy administrators were comprised of state-appointed personnel, which led to government interference in the bankruptcy process. Now, the new law

²⁴⁵ See Tenev, S. and Zhang, C., 2000. 'Corporate Governance and Enterprise Reform in China: Building the Institutions of Modern Markets' in *the World Bank and International Financial Corporation*, at 29-30. Available from: http://www2.ifc.org/publications/pubs/corp_gov/China-Corp-Cov.pdf. [Accessed on 24 October 2003].

²⁴⁶ Notes: effective on 1 June 2007

provides creditors the ability to participate in the selection of bankruptcy administrators. Here, the role of bankruptcy administrator may be assumed by a liquidation group comprised of the relevant departments and organs or by intermediary agencies, and creditors may nominate a law firm, accounting firm, manager or receiver in accordance with the law (Art. 24).

Subsequently, the new law serves as another example where the piecemeal and compartmental approach, adopted by the trial bankruptcy law, evolved into a coherent enterprise bankruptcy law, albeit with socialist characteristics. In this respect, it is said that while the passage of the 2008 new bankruptcy law represents a milestone shift towards market-oriented system, it is still distinctively socialist in nature. According to Halliday, the fundamental issue of the Chinese bankruptcy system is ideological, namely the differences between a “socialist” market economy and a socialist “market” economy.²⁴⁷ Advocates of the former sought to protect, within the confines of a bankruptcy system, both state-owned enterprises and workers from the full force of the market, whereas advocates of the latter sought to absorb all enterprises into a bankruptcy law that protected domestic and foreign financial creditors. In the market-oriented approach, workers are invariably laid-off and their welfare protection misaddressed outside of the bankruptcy regime. In the socialist-oriented approach, the modernization of the Chinese economy is envisaged as a market with Chinese characteristics, and not to be completely drifted away from China’s socialist past.

²⁴⁷Halliday, T. ‘The Making of Chinese Corporate Bankruptcy Law’ in *Rule of Law in China: Chinese Law and Business*, published by the Foundation for Law, Justice and Society, in collaboration with The Center for Socio-Legal Studies, University of Oxford. Available from: <http://www.fljs.org/uploads/documents/Halliday.pdf>. [Accessed on 3 January 2010]

The debate between the two camps on the issue of priorities of workers and creditor rights during the drafting process can be characterized as iterative. In the 1996 draft, similar to the 1986 trial law, workers were given unlimited priority for payment. While this satisfied the representatives of the workers, it threatened a backlash from financial creditors. By 2004, the draft had changed the ranking: first, secured claims by creditors; second, administrative costs to professional and others involved in the proceedings; third, worker claims within limits; fourth, taxation claims without limits; and fifth, unsecured creditors. This proposal came up against a powerful workers' coalition, which asserted that a socialist country should be in favor of workers and insisted the claims of workers should displace those of banks and secured creditors. In the first review in the NPC standing committee, in consideration of social stability, the ranking was reshuffled with first priority to administrative cost, second priority to worker claims, third priority to secured creditors, fourth to tax, and fifth to unsecured creditors. By the second review in the NPC standing committee, with banks acting as a political interest group insisting on commercial criteria, the banks declared that if workers retained priority over secured creditors, then banks would refuse to lend money to enterprises that had heavy debts to workers – a decision that would have severe consequence to companies. The economists and academics supported the banking institutions' position. Senior leaders were divided on this policy issue. After months of stalemate, the 2006 new law produced an artful compromise. Article 113 provides that workers claim ranked second only to administrative costs. But Article 132 qualifies this by stating that Article 113 priorities will only apply until June 1, 2007. After

the implementation date, the priority will be, in rank order, administrative costs, secured creditors, worker expenses incurred after 1 June 2007 and finally tax and unsecured claims.²⁴⁸

Similarly, on the test for access to bankruptcy law, the debate is equally illustrative of the iterative reform characteristics. The issue of access is important because easy access to bankruptcy may produce a flood of liquidations, whereas it would obviate the value of the law if it was too difficult to gain access.²⁴⁹ The drafting team initially proposed the ‘cash-flow test’, which is commonly used in the common law jurisdictions. The Legal Affairs Committee proposed a cash-flow plus balance sheet test, whereby an enterprise would have to show it could not pay its debts on time and that the firm’s liabilities exceed its assets. The latter test is more time consuming and expensive to demonstrate. At the end, the new law adopted the cash flow plus balance test, but included a clever alternative test, namely cash flow plus a judgment by the court that concluded an enterprise was obviously incapable of paying its debts (article 2). However, this fusion of global standard coupled with distinct ‘Chinese characteristics’ allowed the judiciary to only apply the cash test, but also allowed non-independent court to be vulnerable to political and economic pressures to guard certain enterprises from bankruptcy.²⁵⁰

From the above, it can be said that the bankruptcy law reform was not only a balance act between the global market system and local socialist ideology, but its iterative evolution of change is an important illustration of the iterative and evolutionary manifestation of the pragmatic characteristic of the ideology of Chinese socialism.

²⁴⁸ Ibid.

²⁴⁹ Ibid.

²⁵⁰ Ibid.

3.5 Summary

Capital market is a core institution of any capitalist economy. In fact, capital market is an inherent contradiction with the traditional concept of socialism. The case study of Chinese socialist capital market reform reveals not only the tensions caused by the contradiction, but also the normative forces driving through the process of institutional changes prompted by such tensions.

From a historical perspective, capital ownership and market economy reform form the two pillars of capital market development. These reforms can be characterized as iterative, and more importantly as normative. They are normative because the reforms have essentially necessitated a new interpretation of the socialist ideology in China. Private ownership is one key component of this interpretation. Further, by recognizing socialism as one orientation of the ideology spectrum, such new interpretation can be understood as just yet another instance of socialism along the ideology spectrum. It does not mean that the ideology is rendered obsolete because socialism is not fixed at any particular orientation along this spectrum. In particular, by conceiving Chinese socialism as one of the possible orientations of capitalism and socialism, the evolution of Chinese socialism is not limited to the traditional concept of socialism but includes 'advanced' forms of socialism and 'adapted' forms of capitalist ideas.

It has been shown that capital, ownership and market have the ideological content to transform or advance the Chinese concept of socialism. In this sense, these elements are said to be the defining features of Chinese socialism.

More importantly, the study of the evolution of the constituents of capital market reform offer insights not only into what the driving forces of capital market reform are, but also reveal how these forces shape the Chinese economic reform and socialist ideology in a broader context. In this regard, capital market reform is understood as a successive iterative process. This chapter serves as an application of the iterative theory of institutional changes of the PRC. It illustrates the following: how the institutional methodology can be applied to the study of capital market reform; how the theoretical framework developed in the previous chapter can be used to explain the reform of socialist capital market; and how local pragmatics, self improvement culture, and other local conditions can collectively be constituted as the ‘Chinese characteristics’ of the ideology of socialism in modern China.

Recalling from the iterative theory of the last chapter, it can be seen that, starting from the economic reform policy decision that was made in the 3rd plenary session of the 11th CCP Central Committee Meeting, each subsequent economic reform decision and each legal or socio-political response to such decision can be understood as a part of an iterative process, rather than an isolated ah-hoc event of the reform process. Among them, in this chapter, through the case study of two key components of capital market reform, it is shown that the reformation of property rights, property rights of legal persons, property rights delineation exchange and protection are all iterative and evolutionary – with local institutions and global movements taking part in shaping and re-shaping the process. Further, not only is this iterative process incremental, gradual and evolutionary, but it is indeed also progressively normative and advancing. Accordingly, given that the iterative process continues, the progression will necessarily converge to an ultimate idea, though it is not clear what this ultimate idea is, as the

ideology itself is also evolving. Nevertheless, as each successive change is guided by a self-corrective and self-improving norm, the ultimate idea is progressively more advanced than all the previous ones.

This chapter illustrates that an ideological reform can be achieved when socio-economic conditions are favorable to the change. Hence, ideology alone is not sufficient to explain all institutional changes. This chapter also raises the question as to what guides these institutional changes over the course of the reform. In this respect, I argue that two movements, namely internalization and the open door policy, influence the capital market reform. I also argue that the norm of Chinese pragmatic is the underlying guiding force of change. In the context of regulatory reform, it has been shown that to certain extent the changes are guided by the norms of fairness and stability. All of these norms are scattered underneath various institutions of capital market economy. In the following chapters, I attempt to place them into perspective so that not only it is possible to understand these norms that drive the various institutional reforms but also how these drivers are related from one institution to another.

CHAPTER 4 LAND MARKET REFORM

4.1 Introduction

Before I embark on the normative study of Chinese reforms, which is the core subject of the next chapter, I shall conduct one more case study involving the Chinese land market. Recall that in the previous chapter, I demonstrated how basic norms of capital market institutions drive the iterative evolution of legal framework of capital ownership and market economies of Chinese socialism. In that discussion, I singled out capital, one of the three means of production, as the object of study. The focus of the case study of capital market reform is on the legal framework of ‘securities’ and ‘securities markets’.

In this chapter, I will conduct a similar study by focusing on land, another means of production, as the object of such study. In doing so, I will examine the iterative and evolutionary characteristics of land market reforms, and thereby discover norms pertaining to land market institutions of Chinese socialism. As we shall see later, an important characteristic of land market reform is that the capitalist notion of private ownership is incompatible with the ideology of Chinese socialism. And, as far as land market is concerned, the socialist notion of public or collective ownership remains predominant. Notwithstanding, similar to the case study of capital market, the tensions created by the Chinese land market reform fostered the concept of ownership rights, use rights, and property rights. More importantly, the tensions between the socialist ideology of public responsibility and collective interest, and the capitalist idea of individual liberty and economic utility, serve as clear evidence that the driving forces of the capital market reform could manifest as renewed driving forces of other sectors of the

market economy, namely the land market reform. By taking findings of the two case studies together, it can be argued that this sector-by-sector manifestation of the concept of property rights can eventually advance the entire market economy towards the concept of rule of law, albeit within the context of Chinese socialism. Although this last point is not discussed until the next chapter, I shall however conduct an inquiry into the land market to understand the relations among land, ownership and market institutions, as well as the relations between capital market reform and land market reform.

4.2 Analytical Framework

Similar to the study of capital market reform, I will embark on this study of land market from an institutional approach. This approach entails two steps, namely (i) the analytical development of the land market institutional framework, and (ii) the historical account of the land market institutional changes.

Analytically, I argue that land reform is to be understood from three different perspectives. Firstly, land reform, being closely related to the distribution or re-distribution of land holdings, is in essence a multi-faceted institutional change. This is so because, in its most politicized form, land reform equates to revolution and is the ultimate means available to revolutionary movements or a nation-state in winning over the populace or destroying vested elites.²⁵¹

Secondly, land reform is an economic restructuring of market institutions with land conceived as a means of production (e.g. institutional arrangements pertaining to surveying and granting titles, land consolidation, and settlement programs) Thirdly, land reform is not only concerned

²⁵¹ Ho, P. Introduction - The chicken of institutions or the egg of reforms? in Ho, Peter (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 3

with developmental economic institutions, but also comprises of other non-developmental facets such as reforms that involve political and economic objectives.

By taking these perspectives together, land market reform therefore features state actions to transfer use and ownership rights to land, and thereby inevitably changes social relations and class structure as well as economic performance.²⁵² To that end, it can be said that land reform is about the transformation of rural society as well as rural-urban and state-society relations.²⁵³ Furthermore, by conceiving land market reform as a transformation of rural society, rural-urban, state-society relations, it follows from the iterative theory that land market reform is essentially a series of institutional changes, whose primary goal is to distribute and/or re-distribute land holdings of the country. In this sense, an analytical framework of a land reform program inevitably touches on several critical issues, namely (i) the formal institutions of land ownership and/or land use rights and their relations with economic development, (ii) the legal position of informal and customary institutions vis-à-vis the formal institutions within the change process, and (iii) the role of state governance, and thereby the political ideology in guiding the processes of land market reform.²⁵⁴ While these issues may not be all encompassing to the study of land reform of China, they nevertheless serve as the basic parameters of the subject matter of this chapter. The sections of this chapter are therefore accordingly organized.

At the outset, it should be noted that the first issue concerning formal institution of land ownership, under a traditional capitalist context, pertains to the relation between property

²⁵² Ibid.

²⁵³ Ibid.

²⁵⁴ Ho, P. Introduction - The chicken of institutions or the egg of reforms? in Ho, Peter (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 3

rights assignments and Pareto-optimal outcomes, where it is said that a clear assignment of property rights, a precondition for economically efficient resource allocation and eventually environmental sustainability,²⁵⁵ provides the legitimization for privatized property as the sole most efficient and secure institutional arrangement.²⁵⁶ Indeed, this concept of property, that a formal and well-defined system of property rights is the precondition for economic prosperity, is so pervasive that there have been few serious ideological challenges to its dominance. But, this concept of property is not necessarily applicable under a socialist system. One reason is that, if one defines tenure insecurity as the likelihood that the land user might risk losing his land rights (and associated income flows) at a certain point in the future, then the elimination of such a threat does not have to be accomplished through formal institutions, but by informal institutional arrangements.²⁵⁷ Put differently, under a socialist system, secured tenure of land ownership and/or land use rights does not equate with private property *per se* because, by conceiving common property as private property for the group of co-owners, efficient resource allocation and greater incentives for resource conservation can still be achieved through vesting tenure security in a community of users.²⁵⁸ From this perspective, tenure security serves as one basic yet very distinguishing feature of the analytical framework of land reform programs as adopted in this chapter. Indeed, under the notion of Chinese socialism, China's economic growth has been predominantly perpetuated from a very vaguely defined property institution.

²⁵⁵ See Coase, R. The Problem of Social Cost (1960) 3, no. 1 *Journal of Law and Economics* 1-44

²⁵⁶ Miceli, T.J., Sirmans, C.F. and Turnbull, Geoffrey K. The Dynamic Effects of Land Title Systems (2000) 47, *Journal of Urban Economics* 370, 387.

²⁵⁷ Ho, P. Introduction - The chicken of institutions or the egg of reforms? in Peter Ho's (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 5

²⁵⁸ Bromley, Daniel W. *Environment and Economy: Property Rights and Public Policy*, Oxford, Blackwell 1991, 25.

The second and third issues are concerned with the informal institutions of land ownership and the role of the state in land markets. In this regard, it can be said that, from both capitalist and socialist perspectives, any national government that has embarked on the path of economic reform is or will be, at a certain stage of the reform, be confronted with the question of what position informal institutions should be accorded relative to the formal, statutory institutional framework.²⁵⁹ That is, the disregard or recognition of land claims that predate the statutory legal system is often unwritten and fluid as opposed to registered and clarified in nature. However, from an iterative and evolutionary perspective, customary land claims will naturally call for a decision on the formalization of customary land claims into statutory law. Further, regardless of formalization or not, customary land claims must necessarily call into question the role of state governance in guiding institutional change caused by land reform. The state's responsibility of creating the necessary institutions to stimulate the emergence or guide the development of a land market, as well as the state's responsibility to regulate land markets in accordance with its overall social objectives, implicitly suggests that, in respect of the state's role in guiding the transition and development of land reform programs, "getting the institutions right" is more critical than "getting the prices right". Hence, as land resources become increasingly marketized and commodified, it is utmost important that the state shall undertake its responsibility of ensuring such an emerging land market does not result in a rapid concentration of land holdings fall into the hands of a powerful few.²⁶⁰ From this perspective,

²⁵⁹ Ho, P. Introduction - The chicken of institutions or the egg of reforms? in Ho, Peter (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 6

²⁶⁰ Ho, P. Introduction - The chicken of institutions or the egg of reforms? in Peter Ho's (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 8

the role of the state, and thereby the political ideology is an important ingredient and distinguishing feature of the analytical framework of the Chinese land market reform.

In summary, China's socialist land market reform hinges on formal concept of property rights as well as the role of the state and its ideological objectives.

4.2.1 Perspectives of Chinese Land Reform

From the above, the study of land market reform is not entirely about the development of private property right, even though such development has proven to be fundamental in the case study of the capital market reform in the previous chapter. That being the case, private property right plays different roles in the reforms of land and capital markets.

Land market reform can roughly be divided into rural land market and urban market reforms. In this chapter, I shall focus only on rural land market, as opposed to urban land market of the PRC. In the discussion, as a matter of convenience, I shall distinguish the Chinese land market reforms into three periods. In the first period, between 1949 and 1956, land market is characterized by the existence of private land ownership. In fact, prior to the establishment of the PRC, private ownership of land and property had already existed in China and with the founding of the PRC in 1949, private ownership of land continued under the socialist regime, which declared the "land to the tiller" principle in its interim constitution.²⁶¹ Under the principle, Chinese farmers are assigned with plots of land and dwellings according to household

²⁶¹ Zhang Jialin China's Slow-motion Land Reform, Policy Review Magazine of the Hoover Institution of Stanford University (2010) No. 159, February and March Issue, 59

size.²⁶² Farmers enjoyed full property rights over their land and house, including the rights to farm, live on their land, buy and sell, transfer, and give away the property.²⁶³ This principle was contrasted with the concept of socialist public ownership of land, which was gradually introduced starting in 1953. The latter concept pushed for the nationalization of urban land and property, the collectivization of rural land and the gradual abolition of private and individual land ownership.²⁶⁴ However, the implementation of the new concept and the process of collectivization had been gradual. At first, farmers were forced to join agricultural production cooperatives while still keeping their ownership of land. But, as collective farming spread, farmers had to give their land use rights to these cooperatives.

In the second period, from 1956 to 1978, the land market reform was characterized by the emergence of collectivization. Most significantly, in 1956, the People's Congress in Beijing officially reclaimed all land rights from the farmers and turned them over to the "collectives".²⁶⁵ The policy also stated that farmers who had been stripped of their land were to become "members of the cooperatives".²⁶⁶ By 1958, these cooperatives were gradually transformed into people's communes,²⁶⁷ which in turn were divided into production brigades and teams. The communes were given the power to exercise governmental, political and economic functions over the farmers, who were assigned to different production teams to do daily fieldworks. Under this system, farmers were given "work points" based on the hours they

²⁶² Ibid.

²⁶³ Ibid.

²⁶⁴ Xie, Q., Ghanbari P. and Redding B. The Emergence of the Urban Land Market in China: Evolution, Structure, Constraints and Perspectives (2002) 39, no. 8 *Urban Studies* 1375-1398

²⁶⁵ Zhang Jialin China's Slow-motion Land Reform, *Policy Review Magazine of the Hoover Institution of Stanford University* (2010) No. 159, February and March Issue, 60

²⁶⁶ Ibid.

²⁶⁷ Ibid.

worked in each year. Some of the work points were paid in the form of grain, while a small part could be paid in cash.²⁶⁸ The sudden change from the first to the second period caused many problems. For one, due to lack of production incentives, the collective system resulted in the rural land being largely underutilized and agricultural output substantively reduced.

Statistically, from 1949 to 1952, when farmers were granted with land ownership rights, the output of grain had risen by about 50% while farmers' purchasing power were doubled.²⁶⁹ But, after rural collectivization, agricultural production constantly declined and farmers lived in poverty. By 1959, famine began spreading and tens of millions of rural people died.²⁷⁰

In the third period, from the beginning of the latest economic reform in 1978 to the present time, rural land reform was characterized by the notion of de-collectivization. Specifically, de-collectivization was evolutionary and gradual. It evolved from the concept of household contract system, whereby farmers' rights to collective land could also include contractual arrangements between the farmers and the collectives. Such arrangement permitted limited rights to "use" the land, as they were not the rights to "ownership". The implementation of the household contract system was gradual and slow. In fact, although the concept was conceived as early as the second half of 1956, when the authorities of Yongjia County, Zhejiang Province, realized that the collective system lacked incentives for farmers,²⁷¹ the household contract system was ideologically considered as the reverse of the socialist principle of collective farming. It was officially prohibited under the document of the Fourth Plenary Session of the Eleventh Central

²⁶⁸ Ibid.

²⁶⁹ Ibid, p.61

²⁷⁰ Ibid, p.61

²⁷¹ Zhang Jialin China's Slow-motion Land Reform, Policy Review Magazine of the Hoover Institution of Stanford University (2010) No. 159, February and March Issue, 61

Committee of the CCP in September 1979.²⁷² However, this policy statement of 1979 was found to be flawed and was corrected later. Under the household contract system, collective land was allotted by contract to individual households. Each household thereby assumed a responsibility as authorized by the contract. In the beginning, this responsibility was tied to output (i.e. farmers had to give a certain percentage of their grain output back to the state and collectives, based on calculation of how much output a piece of land could produce on average).²⁷³ In return, farmers were given management rights over their allotted piece of land. In other words, farmers had use rights over their allocated land and were allowed to keep additional gains produced from the land for their own, while land ownership remained with the collective. Full official recognition of the HRS was given in late 1981.²⁷⁴ By the end of 1983, almost all the households in China's rural areas had switched to the new system of farming.²⁷⁵

The three periods of rural land reform serve to illustrate the policy tensions toward land institutional changes. In this chapter, I shall focus on the third period, whereby I shall demonstrate how the gradual evolution of household contract system has affected the economic, legal, social and political institutions as well as Chinese socialism. To that end, I shall argue that land market reform is yet another example that serves to validate the iterative, experimental, evolutionary, self-correcting, self-improving and pragmatic characteristics of modern Chinese socialism. Moreover, I shall also argue that land market reform, similar to

²⁷² The session adopted the "Decisions of the Central Committee of the Communist Party of China on Some Questions Concerning the Acceleration of Agricultural Development (Draft)". The Draft was promulgated 9 months later by the Fourth Plenary Session of the CCP Central Committee in September 1979. For the text of the decision, see Editorial Board of China Agriculture Yearbook, *China Agriculture Yearbook 1980* Beijing, Agricultural Publishing Press, 56-62. The prohibition of the HRS was stipulated on p.58 of the above text.

²⁷³ Ibid.

²⁷⁴ Yin, Justin Lifu The Household Responsibility System in China's Agricultural Reform: A Theoretical and Empirical Study, *Economic Development and Cultural Change* (1988) 36, No. 3, April Supplement, 201

²⁷⁵ Ibid, p.201

capital market reform, serves as evidence that, insofar, as land as a means of production is concerned, the evolution of the Chinese socialist market economy will foster the concept of property rights.

4.2.2 Institutions of Chinese Land Market

During the period of the latest economic reform, the backdrop of rural land market is that China has been undergoing rapid economic growth driven by an explosive expansion of urban areas accompanied by the rising demand for land.²⁷⁶ At the early stage of the economic reform, rural land market was not yet in existence, as land ownership or land use rights were not freely transferrable among private individuals. In the absence of rural land markets, as economic reform progressed and more farmers migrated to the cities, large amounts of collective land, which could not be transferred and traded, was left idle.²⁷⁷ At that stage, the country was characterized by a dual-track land ownership system, namely land in an urban area was owned by the state and land in rural and suburban areas were owned by the collectives, as well as a land use system that augmented the land ownership system.²⁷⁸

Broadly speaking, land was publicly owned in socialist China under both urban and rural systems. The 1982 version of the Chinese Constitution stipulates two types of public ownership of land - all urban land was owned by the state and all rural land was owned by the socialist rural collectives. Accordingly, the Chinese land market was not only concerned with the

²⁷⁶ Zhang Jialin China's Slow-motion Land Reform, Policy Review Magazine of the Hoover Institution of Stanford University (2010) No. 159, February and March Issue, 62

²⁷⁷ Ibid.

²⁷⁸ Xie, Q., Ghanbari P. and Redding B. The Emergence of the Urban Land Market in China: Evolution, Structure, Constraints and Perspectives (2002) 39, no. 8 Urban Studies 1376

creation and exchange of land ownership rights, but more importantly, land use rights. The study of land ownership rights will provide an insight into the socialist characteristics of the ownership institutions of Chinese land markets, whereas the study of land use rights will offer capitalist perspectives of property right institutions of the same. That is, the study of the institutions of Chinese land market must entail both land ownership and land use institutions. For rural land, it can be seen that the evolution of the household contractual system was gradual. Further, it can also be seen that while the state plays an important role in the development of the land use rights market and retains the right to requisition the collective-owned rural land under the sanction of public interest, the parallel development of individual liberty and economic utility in other sectors of the Chinese market economy and the interplays between the socialist goals of public responsibility and collective interest and the capitalist ideas of individual liberty and economic utility are essential in shaping past land market reform. These observations will provide important insights for charting future land market reform.²⁷⁹

Notably, rural land market was allowed to flourish only to the extent that rural land ownership remained in the hands of the state, although its use rights can be distributed to the households of rural collectives.²⁸⁰ This socialist characteristic of the Chinese rural land market is a contrast with the previous case study of capital market reform, and serves as an important evidence in the assertion that the capitalist concept of property rights and rule of law are compatible with the socialist regime of public ownership and market economy. Hence, for our intents and

²⁷⁹ See generally Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011

²⁸⁰ Xie, Q., Ghanbari P. and Redding B. The Emergence of the Urban Land Market in China: Evolution, Structure, Constraints and Perspectives (2002) 39, no. 8 *Urban Studies* 1376

purposes, the study of Chinese land market shall be focused on three institutions, namely land ownership right, land use right, and land market per se.

4.3 Rural Land Reform

4.3.1 Rural Land Ownership

Legally speaking, the highest legal authority of Chinese land ownership is found in its constitutional stipulations. The Chinese Constitution of 1982 insisted that, “the basis of the socialist economic system of the PRC is socialist public ownership of the means of production, namely, ownership by the whole people and collective ownership by the working people”.²⁸¹ The Constitution further stipulated that land in the rural and suburban areas are owned by the collective, except for the portions that belong to the state in accordance with the law. Furthermore, house sites and private plots of cropland and hilly land are owned by collectives.²⁸² This 1982 version of Chinese Constitution prescribed collective ownership rights as a kind of public property right that should be affirmed and protected by the legislations of the PRC. However, one important issue remained unclear at the time of the constitutional enactment; what were the legal subjects of the collective land ownership suppose to be. The issue of legal subject of collective land ownership has a close bearing with the operation of a rural land market. Hence, such institutional development has significant importance to the inquiry of rural land market reform. In the following, I will illustrate how the norms of the socialist institutions have helped to resolve the subject matter iteratively and normatively.

²⁸¹ Article 6, PRC Constitution, 1982

²⁸² Article 10, PRC Constitution, 1982

Before such inquiry, it is useful to gain insight into the background of the institutional arrangement of rural land ownerships. In this regard, two major reforms adopted in the early 1980s in respect of China's rural people's commune system are worth noting. The first one was the introduction of the household land contract responsibility system, whereby the farmers got the land management right by contract, while rural land ownership was under collective ownership. The second one was the separation of the role of the government from the farmers' union. These institutional changes entailed among others the establishment of the township governments, villagers' committees, and cooperative economic organizations of township and villages in rural areas, some of which were to serve as legal subjects of these collective land ownerships.

When the General Principles of Civil Law ("GPCL") was first promulgated²⁸³, different subject types of collective ownership of rural land were prescribed. The basic law stipulated that the collective owned land shall be owned collectively by the village farmers in accordance with the law, and shall be managed and administered by the village agricultural production cooperatives, other agricultural economic collectives, or villagers' committees. Land already under the ownership of township farmers' economic collectives may be collectively owned by the farmers of the township.²⁸⁴ Therefore, the GPCL provided legal clarity of subject types of rural land ownership but failed to make clear who represented the various subject types. As a result of this ambiguity, collective land ownership certificates were often not issued in many rural areas. And, in the absence of the legal subjects of collective land ownership, severe problems of

²⁸³ GPCL was promulgated on April 12, 1986

²⁸⁴ Article 74(2), GPCL, 1988

unlawful transfer of rural collective land and loss of lots of cultivated land in many instances were caused.²⁸⁵

In 1988, as a result of the promotion and development of non-public economic activities, the Chinese Constitution was amended to formally recognize the private sector as a “complement” to the socialist public economy, and stated that the, “individual, private and other non-public economies are major components of the socialist market economy”.²⁸⁶ The Chinese Constitution was further amended in 1993 to affirm the socialist market economy as the foundation for economic policy.²⁸⁷ Later, in addition to raising the status of private ownership and the policy of socialist market economy, in 1999, the Chinese Constitution was further amended to introduce the concept of “primary stage of socialism” which provided that before true Marxist socialism can be achieved, China must endure a period of market economy. The importance of these series of constitutional amendments is ideological in that any form of ownership that meets the criterion of improving social productivity and improving the standard of people’s lives should be seen as serving socialism.²⁸⁸ This ideological reform, as coded in the Chinese Constitution, serves to clear the path for the gradual and evolutionary recognition of the notion of individual private property rights. In 1995, a semi-official proposal on property legislation was published. In October 1997, Jiang Zemin made a speech to the CPC 15th National

²⁸⁵ Wang, Liming Rural Land Ownership Reform in China’s Property Law, *Front. Law China* (2006) 3, 311-328

²⁸⁶ Article 11, PRC Constitution, amended 1988

²⁸⁷ See “Draft Amendments to Constitution Discussed” Beijing Xinhua English Service March 22, 1993 in FBIS Daily Report – China (FBIS-CHI-93-054) March 23, 1993, pp.13-14 and Potter, Pitman Property Law in Michael J. Moser and Fu Yu’s (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.5

²⁸⁸ Long, Qinglan, Reinterpreting Chinese Property Law, *Southern California Interdisciplinary Law Journal* (2009-2010) 19, 55-72, 64

Congress, which helped to set the stage for the re-examination of the conventional boundaries of property rights as set forth in the GPCL.²⁸⁹

However, despite the ideological breakthrough of private property, it is said that the influence of the notion of private property on legal institutions remained subject to the general tenor of constitutional provisions favoring socialist public ownership over private property rights.²⁹⁰ In particular, such ideological evolution did not result in immediate corresponding legal institutional changes in respect of rural land ownerships. This phenomenon is explained by the observation that prevailing socio-political conditions were not favorable to such legal institutional reforms at the time. It was not until 1998 that an amendment was then made to effectuate such ideological development on private property rights into legislations governing the ownership of rural land. Specifically, the Land Administration Law (LAL) was revised to prescribe that farmers' collectively owned land, land that is owned collectively by the farmers of the whole village, shall be managed and administered by the village economic collective or villagers' committee.²⁹¹ Furthermore, land that was already owned collectively by the farmers of two or more rural economic collectives within a same village shall be managed and administered by the respective rural economic collectives or villagers' groups.²⁹² Land that was already owned collectively by township farmers shall be managed and administered by the township rural economic collectives.²⁹³ Hence, the GPCL and the LAL together provided three subject types of rural land ownership, namely (i) land collectively owned by the farmers of

²⁸⁹ Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.5

²⁹⁰ Ibid.

²⁹¹ Article 10, Land Administration Law, 1998

²⁹² Article 10, Land Administration Law, 1998

²⁹³ Article 10, Land Administration Law, 1998

villages and managed and administered by the village economic collective or villagers' committee, (ii) land collectively owned by the farmers of the townships, and (iii) land collectively owned by the farmers of two or more rural economic collectives within the same village.

The legal reform of rural land ownership as evidenced in the 1998 version of LAL merely clarified the administration and management responsibilities of various types of collectively owned rural land, but did not completely clarify the problem of who represented the legal subjects of collective ownership. In particular, in respect of the second subject type, township or town authority being a government agency cannot fully represent farmers to exercise the land ownership right as this will violate the principle of separation between government and enterprises.²⁹⁴ Furthermore, the villagers' committee, as a rural mass organization of self-management, does not actually own the collective land. The slack organization of such committee exposed the collective land to abuse of power by a small group of people who dominate the villagers' committee.²⁹⁵

Notwithstanding the rising constitutional status of individual private property rights from 1988 to 1999, land ownership remained as a public and collective concept. Insofar as land ownership as a collective concept is concerned, the ambiguity of the legal subjects of collective land ownership inevitably caused problems related to the protection of farmers' interests in the lands. Firstly, since the collective land was owned by plural subjects, it was hard to determine which one should be registered as the owner. Without clarity in the registration of land owners,

²⁹⁴ Wang, Liming Rural Land Ownership Reform in China's Property Law, Front. Law China (2006) 3, 315

²⁹⁵ Wang, Liming Rural Land Ownership Reform in China's Property Law, Front. Law China (2006) 3, 315

it was possible for the managers or administrators of the collective land, namely the officials of the township or the villagers' committee, to advocate their own interests that may have been in conflict with the individual farmers. Secondly, the villagers' committee was neither a juridical person nor a government agency. The collective land was then actually "owned" by the head of the village or a few members of the villagers' committee.²⁹⁶ Thirdly, the three-level ownership system (town, village, villager group), paired with the above mentioned problems, caused more complications and often resulted in ownership disputes between villagers groups and villager' committee, and between villagers' committee and township governments.

One scholar attempted to explain the above rural land ownership structure from a collectivization movement perspective.²⁹⁷ Wang argued that, in the 1950s, the rural collectives, which encompassed the concept of communes, brigade and production team, were originally designed for a system of collective agricultural production and distribution that would be based on common ownership of all economic means and resources. The de-collectivism movement at the end of the 1970s, which heralded the collapse of the collective production / distribution and the abolishment of collective economic organizations in most rural areas,²⁹⁸ naturally led to the corresponding legal reform of rural land ownership. While Wang did not elaborate on the process of change of the concept of collective ownership of rural land, it is conceivable that, according to the iterative theory, such process of change is caused by the tension created by the economic reform of de-collectivization and the implementation of the household contract

²⁹⁶ Chen Xiaojun et. al. *Law System: Explanation on the Field Survey*, China University of Political Science and Law Press, Beijing (2004) 264

²⁹⁷ Wang, Weiguo *Land Use Rights: Legal Perspective and Pitfalls for Land Reform in Ho, Peter (ed.) Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 73

²⁹⁸ Wang, Weiguo *Land Use Rights: Legal Perspective and Pitfalls for Land Reform in Ho, Peter (ed.) Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 72

system on the one hand, and the distribution of land holdings and legal rights of the village farmers toward these land holdings on the other hand.

In the face of the ambiguity of legal subjects of rural land ownership structure, Wang offered several suggestions: (i) nationalization, which boils down to the abolishment of the collective ownership of rural land and granting all ownership of land resources to the state;(ii) privatization, which means the abolishment of collective ownership to rural land but rather allocating land ownership to individuals or farm households; (iii) multiple ownership, by abolishing the collective ownership to a certain part of rural land and subsequently vesting the ownership of this land in the state and individual farmers, while the remainder stays in collective ownership; and (iii) restructuring collective ownership, which implies maintaining collective ownership to rural land, but simultaneously transforming its structure in order to strengthen farmers' land use.²⁹⁹

Suffice it to say, in the context of this case study, any corresponding responses to the tension of rural land ownership structure will hinge upon the ideological interplays between the socialist goals of public responsibility and collective interest and the capitalist ideas of individual liberty and economic utility in China.³⁰⁰ The iterative theory serves as a useful tool to understand what these tensions are and how the process of economic, legal, social and political reforms will help the institutions to evolve towards the ultimate solution over times. Understandably, the household contract system has decentralized state authority in management and privatized

²⁹⁹ Wang, Weiguo Land Use Rights: Legal Perspective and Pitfalls for Land Reform in Ho, Peter (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 72-73

³⁰⁰ Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011

production, but does not extend to offer farmers with individual land ownership. The continued ambiguity of legal subjects of rural land should be understood as a balanced act of economic incentives brought by the household contract system and ideological constraints imposed by collective land ownership structure. The ambiguity is a source of motivation of continued legal and political reform. The absence of formal legal relations on rural land ownership allowed the government to acquire rural land in the disguise of public interest. Notably, this dilemma will create ongoing tensions not only in respect of the issue of legal subjects, but also the question about the role of the government over rural land uses.³⁰¹

Potter observed that the Chinese Constitution was amended to sanctify individual private property to the same inviolable level as public property in 2004, whereby Article 13 of the Constitutional Amendment states that lawful private property shall not be violated while provision in Article 12 states that “socialist public property is sacrosanct and inviolable”, and accordingly the rejection of the proposed application of the term “sacrosanct” to private property underscored the continued privileging of public property.³⁰² This observation of the ongoing privileging of public property in the context of land ownership reform is supported by further evidence under Article 10 of the 2004 Constitutional Amendment, where it stipulated that “the state may, as needed in the public interest, take over or use citizens’ private property in accordance with the law, and give compensation.”³⁰³

³⁰¹ Long, Qinglan, Reinterpreting Chinese Property Law, *Southern California Interdisciplinary Law Journal* (2009-2010) 19, 55-72, 66

³⁰² Potter, Pitman Property Law in Michael J. Moser and Fu Yu’s (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.9

³⁰³ Article 10, PRC Constitution, amended 2004

The promulgation of the new Chinese Property Law in 2007 was read seven times by the Standing Committee of the National People's Congress and took effect on 1 October 2007. It stipulated equal legal protection of state-owned, group-owned and private-owned property, but appeared to have done very little to change the conditions of the farmers insofar as rural land ownership was concerned. Notably, of the 247 articles contained in the new law, only one chapter consisting of eleven articles directly deals with the governing of farmland, and several of those articles simply refer readers to the law on the contracting of rural land or other laws already in effect.³⁰⁴ That is, despite the landmark provisions concerning the equal protection of state-owned, group-owned and individual-owned properties, the new Chinese Property Law has not changed the basic ownership structure of rural land, which is either state-owned or collectively owned.

In summary, the reform of rural land ownership in the context of economic reform has been gradual and incremental. The historical account of the reform is yet other evidence that the normative content of the reform is heavily influenced by the interplays of the ideology of the socialist goals of public responsibility and collective interest and the capitalist ideas of individual liberty and economic utility. The ambiguities of legal subjects of rural land ownership and the role of the state in relation to land use rights are examples of these tensions and interplays. That being said, it is my contention that the existing state of the rural land market is far from its ultimate ideal. Though, the iterative theory suggests that the tensions between the socialist

³⁰⁴ James, Benjamin W., Expanding the Gap: How the Rural Property System Exacerbates China's Urban-Rural Gap, *Columbia Journal of Asian Law* (2007) 20, 452-491, 473

goals and capitalist ideas of past reform are the catalysts of the ongoing reform and provide the impetus to ensure convergence towards an ultimate idea that is equitable with local condition.

4.3.2 Rural Land Use Rights

From the above, it can be seen that gradual and evolving elevation of the legal status of private ownership, as evidenced in the case study of capital market reform, has not achieved the same effect in the case of land market reform, in the sense that the land market reform has not affected the formal structure of land ownership institutions. However, the same is not true in respect of customary and informal institutional arrangements of rural land holdings, otherwise known as land use rights.

The concept of land use rights pre-dated the constitutional recognition of land use rights and transferability of such rights of 1988. In the de-collectivism movement of the late 1970s, under the aegis of Wan Li, the provincial governor of Anhui Province at the early stage of the latest economic reform, the household contract system was conceived as a response to tackle the problem of poverty in the agricultural sector of rural China. The household contract system was actually preceded by two different institutional arrangements of collectivism. The first system, known as the *baochandaohu*, under which production was contracted to the household, devolved the responsibility for the cultivation of given plots of land to the household. The household was provided with agricultural inputs by the collective, but was not allowed to decide what to cultivate, nor could it sell the agricultural produce on its own. The second

system, the *baogandaohu*, gave the household both managerial rights as well as the right to sell crops under the condition that the state grain-quota had been met.³⁰⁵

From an institutional perspective, the household contract system was a policy compromise between the ideological premise of public socialist ownership of all means of production and economic goal of providing incentives to farmers to revive the agricultural sector dampened by years of collectivism. From an economic perspective, this policy experimentation has proved to be very successful. Annual grain production increased from a stagnant level of around 280 million tons during the years prior to economic reform to over 400 million tons in the early stage of the reform in 1984.³⁰⁶ From 1989 onwards, annual grain production had never dropped below 400 million tons and reached a record of over 500 million tons in 1998 and 1999.³⁰⁷ The extraordinary result of the contractual system put an end to the commune system. However, the success of the contract-based land lease system also created a new economic situation, where farmers demanded more certainties pertaining to the tenure of the agricultural lease (as well as of other land-based industries, such as forestry, animal husbandry and fishery),³⁰⁸ and more safeguards toward farmers' long-term investment over the leased lands. The tensions created by these new demands prompted for more reforms. One reform which was within the remit of the economic and legal institutions was that the lease period was extended for farm households, thereby incrementally increasing the length of the lease period,

³⁰⁵ Ho, P. Introduction - The chicken of institutions or the egg of reforms? in Peter Ho's (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 25; See also Unger, Jonathan *The Transformation of Rural China*, and London, M.E. Sharpe 2002.

³⁰⁶ Ibid, p.11; State Statistical Bureau (ed.) *QuanguoGesheng, Zizhiqu, Zhixiashi, LishiTongjiZiliaoHuibian – 1949 – 1989* (A Compilation of Historical Statistics of all Provinces, Autonomous Regions and Municipalities - 1949-1989), Beijing, China Statistics Press 1990, 12.

³⁰⁷ Ibid, p.11; State Statistical Bureau (ed.) *China Statistical Yearbook*, Beijing, China Statistics Press 2001, 380.

³⁰⁸ Ho, P. Introduction - The chicken of institutions or the egg of reforms? in Peter Ho's (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 12.

starting from only 5 years at the start of de-collectivation in 1978 to 15 years in the early phase of the reform in 1984 and then to top-up another 30 years over the original contract in the later stage in 1993.³⁰⁹ Another reform, which involved socio-political and legal institutions, was that local authorities were discouraged from frequently adjusting land distribution rights after the first lease of de-collectivization, since it rendered tenure insecurity of those leased land. By 1997, the Secretariat of the CCP and State Council formally proclaimed a directive that prescribed a stable lease period free from reallocations for 30 years.³¹⁰ This latter policy was written into the Land Administration Law of 1998 ("LAL").³¹¹ According to the 1998 LAL, farmers, for the first time since de-collectivization, would be provided with written individual, standardized, and notarized land leased contracts by the provincial governments.

The LAL is, in part, a legal response to the tensions of administration and rationalization of land usages on one hand and economic success of the de-collectivization movement on the other hand. As such, in addition to addressing the issue of tenure security, the legal response entails both the constitutional principles of public ownership of land and the jurisdictional arrangements for land administration.³¹² Article 1 of the LAL states that the purposes of the legislation is to strengthen the administration of land, safeguard the socialist public ownership of land, protect and develop land resources, ensure a rational use of and giving a real

³⁰⁹ Ho, P. Introduction - The chicken of institutions or the egg of reforms? in Peter Ho's (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 25; 12.

³¹⁰ Ho, P. Introduction - The chicken of institutions or the egg of reforms? in Peter Ho's (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 25; 12

³¹¹ The Land Administration Law was promulgated in 1986 and amended in 1988 and 1998.

³¹² Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.10

protection to cultivated land to promote sustainable development of the socialist economy.³¹³

The safeguard to the socialist public ownership is explained under Article 2 of the LAL, whereby the state maintains the right to expropriate and requisite land for public interests.³¹⁴ However, to rationalize the expropriation of agricultural land by the state, the LAL stipulates that the state is required to compensate accordingly when it chooses to take land from individuals and non-state entities, and such takings may only be done for public interests.³¹⁵ Notably, the LAL distinguishes three different types of land, namely land for farm use, land for construction use, and land unused.³¹⁶ Each of these land types should be used strictly in line with the purposes of land use defined. The LAL reiterates that urban land is owned by the state, and farmers collectively own rural and suburban lands. The corollary of this stipulation of land ownership by the LAL suggests that farmers are not allowed to own the land individually. Specifically, if it is the farmers' desire to use land at the exclusion of other individuals, they must contract with the collective, the land's legal owners,³¹⁷ in which case the collectives can lease their land to individual farmers for a term of thirty years. It is required that such lease contract must be in writing and specify the respective land use rights of the contracting farmers. This way, the land uses are accordingly limited to those purposes expressly allowed by the lease. Moreover, in order to further govern the permitted land uses, the LAL stipulates that any adjustments to

³¹³ Article 1, Land Administration Law of the PRC, 1998 and amended 2004

³¹⁴ Article 2, Land Administration Law of the PRC, 1998 and amended 2004

³¹⁵ James, Benjamin W., Expanding the Gap: How the Rural Property System Exacerbates China's Urban-Rural Gap, *Columbia Journal of Asian Law* (2007) 20, 452-491, 467

³¹⁶ Article 4, Land Administration Law of the PRC (1998), amended 2004

³¹⁷ Article 14, Land Administration Law of the PRC (1998), amended 2004

alter the land use rights during the term of the contract must be approved by a variety of government bodies, including two thirds of the villagers' congress or representatives.³¹⁸

From the above, it can be seen that the LAL provides clarity to the legal relation between contracting parties of rural land leases, but entrusts significant discretionary power to local government in respect of rural land administration. As such, one main discontent of the farmers is that if a change in circumstances renders current land use unprofitable, those that have angered local officials may be stuck with a useless plot of land and rent payments.³¹⁹ This socio-political tension between farmers and local governments thereby demanded further reforms in respect of the legal relations between the contracting parties of the rural land leases. Specifically, it is desirable to clarify the two-level operation system of land use rights (the two levels being individual households operating under the principles of the household responsibility system and the unified management of the collectives), as well as protect the legal rights and interests of the parties of the contracting of rural land.

In 2002, the Law of the PRC on the Contracting of Rural Land ("CRL") was adopted, and became effective on March 1, 2003. The CRL was perceived as a legal response to the new socio-political situations pursuant to the 1998 LAL. Nevertheless, the CRL merely provided partial response to the new situation. Article 1 of the CRL reiterates that the purpose of the legislation is to stabilize and perfect the two-level operation of the household contract system, and to protect the legal rights and interests of the parties of the contracting of rural land, so as to

³¹⁸ Ibid.

³¹⁹ James, Benjamin W., Expanding the Gap: How the Rural Property System Exacerbates China's Urban-Rural Gap, *Columbia Journal of Asian Law* (2007) 20, 452-491, 468

improve the development of agriculture and the rural economy, and stabilize the rural areas.³²⁰

The CRL stipulates that such protection is a prohibition on selling and purchasing of rural land and that ownership of the land itself remains with the collective.³²¹ The CRL also provides a rationalization of land use and development of agricultural land by stipulating that the legal rights and interest of such leased land use shall also include rights to transfer to other parties.³²² On one hand, these provisions address the ownership right of the collective. On the other hand, these provisions confirm the transfer rights of the farmers of the leased land.

Notwithstanding these clarifications, two key issues remain unresolved. First, while the LAL and the CRL together provide the legal framework regarding land use rights of rural lands, the legal nature of land use rights remains unclear.³²³ Second, while the LAL and CRL clarifies the administration and management of the two-level rural land ownership system, the legislation does not adequately provide safeguards to shortcomings exposed by the significant discretionary approval power of the local government in respect of the lease use of rural land.³²⁴

The first issue relates to land use right as a real right or personal right. By this, it is meant that a real right is a right *in rem* or a “right against an object”, which enables the entitled to possess it exclusively. In contrast, a personal or obligatory right is a right *in persona* or a “right against a person,” which enables the entitled to demand payment or some other performance from a

³²⁰ Article 1, Law of the Contracting of Rural Land, 2002

³²¹ Article 3 and 4, Law on the Contracting of Rural Land, 2002

³²² Article 10, Law on the Contracting of Rural Land, 2002

³²³ Wang, Weiguo Land Use Rights: Legal Perspective and Pitfalls for Land Reform in Ho, Peter (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 65

³²⁴ Ibid.

responsible person under the law.³²⁵ The significance of this distinction is that, if an owner had been wrongfully dispossessed of a thing, the real right would entitle its owner to restore possession of the thing, whereas in a personal action, the court would only allow payment of thing's value, instead of compelling its return.³²⁶ The second issue, which is consequential to the first, relates to the role of the local government in the transfers of land use rights under the LAL and CRL framework.

One scholar suggests that under the Chinese land system, the clarification for the above two issues is not only a matter of legal institutional reform but also about social and political institutional changes.³²⁷ In the terminology of the iterative theory, this is equivalent to saying that the tension created by these two issues will demand institutional changes in the social, political as well as legal and economical spheres. Indeed, the origin of the relevant institutional change of permitting transfers of contracted land can be traced to the Central Committee Document No. 1 of 1984.³²⁸ There, the CRL affirmed the applicability of the policy to the household responsibility (*chengbao*) contracts, which, *inter alia*, also provided that the transfer of such rights was subject to the approval of local authorities.³²⁹ The policy and its subsequent codification in the CRL thereby created a new economic situation, where the new socio-political relation between local authorities and rural land use rights holders were in constant tensions

³²⁵ Wang, Weiguo Land Use Rights: Legal Perspective and Pitfalls for Land Reform in Ho, Peter (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 65

³²⁶ Ibid, 64. For more information on real versus personal rights, see Simpson, R. Rowton *Land Law and Registration* Cambridge, Cambridge University Press 1976, 24-26

³²⁷ Wang, Weiguo Land Use Rights: Legal Perspective and Pitfalls for Land Reform in Ho, Peter (ed.) *Developmental Dilemmas: Land Reform and Institutional Change in China* London and New York, Routledge 2005, 65

³²⁸ Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.10

³²⁹ Law on the PRC on Land Contract in Rural Areas (Order of the President No. 73) (Oct. 8, 2005) http://www.gov.cn/english/2005-10/09/content_179389.htm; Rural Land Contracting Law of the PRC: Case and key interpretation edition) Beijing, China Legal Publishing House 2009, esp. Articles 37-39 pp.49-57

over the issues of land use rights and its transferability over these leased rural land. Despite these tensions, the State Council edicts in 2004 and 2006 retained the basic system of control over these transfers,³³⁰ and at the same time gradually conceded to compensating people for expropriation of rural land.³³¹ In 2004, the policy was coded into the LAL and replaced the outdated concept of termination around 'requisition' with the term 'expropriation'.³³² The LAL legal reform of 2004 thereby responded to the social tension caused by rural unrest on one hand and state intrusion on land use rights on another.³³³ Notably, the legal response also attempted to bring about conformity with constitution recognition of private property.³³⁴ However, the LAL and CRL did not directly address the tension between local authority and farmers over land use rights, but opted to introduce the concept of adjudication of farmers' legal rights in land contracting disputes. This judicial approach was further reinforced in 2005, whereby regulations were issued by the Ministry of Agriculture which set forth specific rules for transfers of land contract rights, and established oversight authorities of the rural land contracting administration agencies.³³⁵ An interpretation were issued by the Supreme People's

³³⁰ See "State Council decision on deepening reform of administration of significant land (Oct 21, 2004) and State Council notice on issues of strengthening land adjustment and control (Aug 31, 2006)" cited in Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.15

³³¹ See "Order of the President of the People's Republic of China No. 28," Aug. 28, 2004 (<http://www.lawinfochina.com/law/display.asp?ID=3670&DB1&keyword=>) [May 18, 2010] cited in Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.16

³³² Ibid.

³³³ Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.16

³³⁴ Ibid

³³⁵ Ibid

Court which supported adjudication of land use rights, thus bringing judicial institutions to bear on the contested policy issues of public and private rights to use.³³⁶

The tension between local authority and land use right holders continued to be a source of further reforms. On one hand, the abuse by the local government in the approval process of rights' transfers prompted new policies to remove the government approval requirements for certain types of land use rights transfers.³³⁷ On the other hand, the central principle that the state should continue to play a critical role in respect of land use rights caused institutional establishments to permit continual state intrusion in these transfer of property interests in land.³³⁸

Particularly, this dilemma of balancing public and private interests is evidenced in the draft revision of LAL when the fourth drafting session convened in Beijing in February 2010.³³⁹

Nevertheless, the legal principle that land ownership rights reside with the state and the collective means, in effect, that rights to land, including rights of uses and transfers, remain subject to the discretion and consent of the state.³⁴⁰ This approach denies the presumption of individual rights to private ownership of property in land and contrasts with private property rights in capital market reform as discussed in the previous chapter.

³³⁶ The Rural Land Contracting Law of the PRC: Case and key interpretation edition, Beijing, China Legal Publishing House 2009, pp. 102-107

³³⁷ Land system reform takes a key step, in *Caijing* (Finance) Oct. 20, 2008

³³⁸ Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.17

³³⁹ "Land system reform 1: Who benefits? Who plots?" (<http://china-review.com/lawweekly.asp?id=5250> [April 8, 2010]) cited in Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.18

³⁴⁰ Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.18

In summary, the historical account of land use rights reform serves to demonstrate the ongoing tensions between private and public property on one hand, and land use rights and state control on another hand. Both, nevertheless, continued to be the main driving force of the continuing land reform in socialist China. More importantly, the case study of land use rights serves as strong evidence to the assertion that the capitalist ideas of individual liberty, economic utility, and property rights are compatible with the socialist goals of public responsibility, collective interest, and state control. That being the case, the existing state of the rural land use rights regime is far from its ultimate idea. Though, as stated before, the iterative process of interplays between these tensions of socialist goals and capitalist ideas will provide the impetus to advance the current regime towards its ultimate solution. This ultimate solution will necessarily be equitable with local condition, including a socialist conception of rule of law that supports and recognize individual land use rights within the broader conception of property rights in socialist China.

4.3.3 Rural Land Market

This section extends the study of land use rights into the context of a market economy and focuses on the tensions of land use rights that are pertinent to the development of rural land markets. The first tension is concerned with the legal nature of land use rights (i.e. whether rights to land use are real rights or obligatory rights?) The second tension is concerned with the ideology constraints of socialist public ownership (i.e. how do private property rights evolve within the confines of socialist public ownership in China?)

The above two aspects of rural land market are distinctively important for the following reasons. Firstly, as discussed before, as a property rights infrastructure, a rural land market must provide the basic functions of rights delineation, rights exchange, and rights protection. The legislation of LAL and CRL, which defined the concept of land use rights and the transfer of such rights, albeit subject to local authority approval, therefore satisfied two of the three premises of rural land market development. Yet, as I point out before, with the legal nature of land use rights being unclear at the time, the issue of legal protection of land use rights arising from transactions of the rural land market will remain a major concern. Secondly, the clarity of legal definition of land use rights and the protection of such rights is subject to the ongoing development of the property law of the PRC, which in turn is shaped by the tension and the interplay of the socialist ideologies of individual liberty, economic utility, public responsibility and collective interest. In particular, how the ideology of socialist public ownership affects the concept of equal protection of public, collective and private property rights in accordance with the new property law is of utmost relevance.

Accordingly, this study of rural land market will be conducted through a reexamination of the historical perspective of the legal nature of land use rights in the light of the new Chinese Property Law of 2007. In doing so, I will examine the drafting process of the property rights law, which was originally mandated in China's 1994 legislative action plan.³⁴¹ In addition, I will examine the provisions of the new law pertaining to the conception of land use rights and its protection. In this regard, I will also briefly provide a historical account of events from March

³⁴¹ Ibid, p.19

1998, when the drafting group of the Chinese property law was initially formed, to October 2007 when the new property law became effective.³⁴²

In relation to the legal nature of land use rights, as an introduction, it is noted that the concept of land use rights as discussed in the preceding section has existed and evolved over the period of the latest economic reform. At the early stage of the reform, according to the LAL, the right to use agricultural land, which is defined as land directly used for agricultural production, including cultivated land, is fundamentally contractual in nature.³⁴³ Hence, the use right (generally termed in China as “the operating right to agricultural land” or 农地经营权) bears more the legal nature of an obligatory right than that of a real right. This interpretation is relevant in situations, especially at the early stage of the economic reform, where there is no sound legal environment in which to regulate transactions for agricultural land use rights and there are abuses by leaders of the rural collectives to terminate farmers’ land use contracts at will.³⁴⁴ On the other hand, Article 80, paragraph 2 of the LAL stipulates that the right of citizens and collectives to contract for the management of land under collective ownership, or state-owned land under collective use, shall be protected by law. If the General Principles of Civil Law and some other laws, including the new Chinese Property Law of 2007, provided adequate statutory protection to the rights to use of agricultural land, then such rights can be understood as a real right rather than an obligatory right.³⁴⁵

³⁴² Membership of the drafting group included Liang Huixing, Jiang Ping, Wang Jiafu, Wang Baoshu, Wei Zhenying, Wang Liming, FeiZongyi, Xiao Xun and Wei Fanrong.

³⁴³ Article 4, paragraph 3, Land Administration Law, 1998

³⁴⁴ Ye, Jianping *Studies on the Rural Land Tenure System in China* Beijing, China Agriculture Press 2000.

³⁴⁵ Also see Article 14 and 15 of Land Administration Law, 1998 and Article 12 of the Agriculture Law, 1993

One objective of the Chinese Property Law of 2007 was supposed to establish a legal environment to protect and to adjudicate disputes related to land use rights. In this respect, a historical account of the drafting of the new property law and the development of the legal nature of land use rights as enshrined in the new property law is provided as follows.

The first draft of the new property law was completed in 1999, which was then used as the basis for the “draft seeking opinions” conducted by the Legal Affairs Committee of the NPC Standing Committee.³⁴⁶ In 2002, the Legal Affairs Committee submitted an initial text to the NPC Standing Committee.³⁴⁷ From the inception of the mandate to draft a property rights law in 1994 to the submission of the initial text of the property laws to the NPC Standing Committee in 2002, the progress of the drafting work has been slow. One scholar attributed this sluggish development to the absence of a favorable socio-political condition and formal recognition of the concept of private property.³⁴⁸ Potter observed that once the Constitution amendment enshrined a right to own private property in 2004, preparation of the law accelerated, resulting in a public release of a draft statute in July 2005.³⁴⁹ The institutional relation between legal social and political is evident in capital market reform and is most prevalent in this context of land market reform. Moreover, insofar as the drafting of the new property law is concerned, the interplay between legal, social and political institutions is not only limited to formal forums, but also occurs in academic and open public discussions. Potter

³⁴⁶ Ai Mo, *Wuquanfa ban an shouce* (Property rights law litigation handbook), Beijing, China Legal Publishing House 2007, pp.1-2.

³⁴⁷ Potter, *Pitman Property Law* in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.19

³⁴⁸ *Ibid.*

³⁴⁹ Potter, *Pitman Property Law* in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.20

noted that, as a result of these discussions, the draft law, which originally intended to provide greater protection of private property, was subject to late-coming criticism from traditionalist intellectuals. It was criticized for contravening socialist principles, and empowered and legitimized land requisitions by local officials for private gain.³⁵⁰ In particular, the draft's principle of 'equal protection' for private and public property was criticized by opponents as contravening the Constitution's distinction between private and public property.³⁵¹ These draft provisions were eventually withdrawn from the draft in mid-2006.³⁵² Subsequently, the draft underwent significant revisions to reflect the importance of protecting public and state property. The focus of the protection of rural land use rights was shifted to the restraining of the authority of local officials in transfer approvals.³⁵³ The tensions between proponents of expanded property rights and traditionalist intellectuals prompted for these revisions prior to formal legislation, causing lengthy delay to the enactment process. The revised draft was reconsidered by the NPC Standing Committee throughout 2006 and was submitted to the full NPC for approval in early 2007.³⁵⁴ The final draft came into force on October 1, 2007.

Potter described the new property law as a basic civil law that acknowledges the increased autonomy of private property relations, while it also underscores the state's continuing role to regulate these relations. As a result of the interplay between the political, academic, and legal

³⁵⁰ Gong Xiantian, "A Property Law (Draft) that violates the constitution and basic principles of socialism," (Aug. 12, 2005); Gareth Powell, "Not everyone supports law on privatization," *China Economic Review* Feb. 25, 2007 (<http://www.chinaeconomicreview.com/property/2007/02/25/not-everyone-supports-law-on-privatization/html>); For subsequent indication of Professor Gong's views, see Gong Xiantian, "Opinion concerning five important questions of principal in the Draft Property Law following the sixth debate, which violate the constitution and must be conscientiously revised" (Dec. 9, 2006)

³⁵¹ Potter, *Pitman Property Law* in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.20

³⁵² *Ibid*, p.20

³⁵³ *Ibid*, p.21

³⁵⁴ *ibid*.

institutions, the final draft embodies provisions of pragmatic compromise, instead of coding property rights and its protection in absolute terms.

Of particular interest is the evolving objective of the legal reform. It is suggested that what began as a legislative drafting effort aimed at supporting the expansion of property rights, became, by the time of enactment, an effort to control property rights and curb abuses.³⁵⁵ This phenomenon is illustrative of the gradual, pragmatic and self-correcting norms of Chinese socialism. The revised draft maintains its emphasis on “equal protection to the property of the state, the collective, and the individual,” though such protection is subject to the emphasis of public responsibility and collective interests. The tension over the boundaries between private rights and socialist goals was left unresolved in legal terms, purposely allowing room for further clarification by institutional arrangements, albeit gradual, incremental, and experimental.

Specific provisions of the new property law serve to illustrate how the law strives to cope with tensions among the socialist institutions of the PRC. Firstly, the new property law provides that property owners have the right to possess, use, dispose of and obtain profits from real property and chattels.³⁵⁶ Such ownership right is subject to the state’s right of expropriation for the purpose of public interest,³⁵⁷ yet expropriation must be accompanied by lawful compensation.³⁵⁸ Secondly, the new law has provisions governing the principle of usufructuary rights, which allow possession, utilization, and profit taking from real property owned by

³⁵⁵ Ibid, p.24

³⁵⁶ Article 39, Property Law of the PRC, 2007

³⁵⁷ Article 42, Property Law of the PRC, 2007

³⁵⁸ Ibid.

others.³⁵⁹ The history of usufructuary rights (*yongyiwuquan*) can be dated back to the beginning of the household contract system of the early 1980s. The new property law affirmed that land contractors, just like any property owners, enjoy the right of possession, utilization, and profit taking.³⁶⁰ Thirdly, while the new property law sets out the general framework of property rights, the issue pertaining to the restriction that land contractors' rights are dependent on approvals from the local authorities remains. However, late revisions to Article 63 of the New Property Law of 2007 permit applications for judicial cancellation of decisions by economic collectives, village committees or their responsible persons if property rights were infringed upon.³⁶¹ Moreover, it should be noted that agricultural contracts to transfer, lease, exchange and assign their contract rights are not given broad autonomy in the new property law. At the Third Plenum of the 17th CCP National Congress in October 2008, while agricultural land continued to be imposed with limits on transfers, non-agricultural land was given a more flexible treatment.³⁶²

In summary, based on a historical perspective, it can be seen that the development of land use rights, particularly in relation to its protection and legal nature, is characteristically evolutionary, gradual and iterative. The ambiguity of the legal nature of the land use rights is a result of the tension between private property rights and state control rather than a lack of legal intellects, as can be seen from the historical account of the drafting process of the new property law.

³⁵⁹ Potter, Pitman Property Law in Michael J. Moser and Fu Yu's (eds.) *Doing Business in China*, Juris Publishing Inc. 2011, p.38

³⁶⁰ Article 125, Property Law of the PRC, 2007

³⁶¹ *Ibid*, p.21

³⁶² "Decision on Major Issues Concerning the Advancement of Rural Reform and Development," October 12, 2008; "China Extends Rural Reform and Development in New Party Document," Xinhua Oct. 19, 2008 (<http://english.cri.cn/2946/2008/10/19/1881s416114.htm>) [May 18, 2010]; "Chronology of the CCP's Decision on Rural Reform, Development" Xinhua Oct. 19, 2008 (<http://english.cri.cn/2946/2008/10/20/65s416331.htm>) [May 18, 2010]

Nevertheless, the tension created by the interplay of the socialist ideologies toward individual liberty, collective interest, public responsibility and economic utility remains a driving force for further reform. More importantly, the historical development of land use market serves as further evidence to the assertion that the capitalist idea of 'market economy' and 'rule of law' is compatible with the concepts of public responsibility, collective interest, individual liberty and economic utility as adopted by socialist China, albeit within the confine of the rural land market.

4.4 Urban Land Reform

Although the preceding sections of this chapter have focused mainly on rural land market reform, or more specifically on rural land use rights reform, it is reckoned that many problems of rural land use rights are systematic and therefore are applicable in varying degrees to urban land use rights. For instance, in relation to the expropriation or requisition of lands by the government, it is reckoned that the lack of definition of the meaning of public interest, lack of checks and balances within the government, and shortcomings of the appellate process in adjudicating disputes arising from government takings of lands are common problems in respect of rural and urban land use rights disputes, though the new Property Law of 2007 is said to have advanced more clarity and protection of urban land use rights than rural rights.³⁶³

In the premise, for the purpose and intent of this dissertation, in this section concerning urban land reform, I shall shift the focus of the discussion to the methodology of reform process

³⁶³ James, Benjamin W. Expanding the Gap: How the Rural Property System Exacerbates China's Urban-Rural Gap (2007) 20, No. 2 Columbia Journal of Asian Law p.473

rather than the iterations of the substantive problems underlying the reform. In this respect, I illustrate yet another instance of the principle of pragmatism of Chinese socialism.

The scope of the urban land reform follows a gradual and experimental approach in accordance with the geography of the reformed areas. Recall that, prior to the land reform, under the Chinese socialist system, urban land was mainly occupied by state enterprises and institutions, including public institutions such as universities, hospitals, schools, state owned enterprises, and collective enterprises.³⁶⁴ The first phase of urban land reform of the contemporary economic reform started in Shenzhen in 1982, which was later extended to other Special Economic Zones and Open Coastal Cities.³⁶⁵ In the reform, the Shenzhen local government was given the discretion to make their laws and regulations in accordance with the principles provided by the central government. These local policy and regulation was gradually introduced in other areas of the city by way of provisional statute. Further, based on the local experience, such urban land reform was then extended to other cities of the whole country as well as other aspects of land reforms, including further agricultural reforms, urban housing system reform.³⁶⁶

Roughly speaking, the Chinese urban land reform can be classified into three stages. In the first period, from 1982 to 1987, the practice of charging land use fees to those using state-owned land was introduced in Shenzhen, the first Special Economic Zone in China. The Shenzhen SEZ Provisional Statute on Land Administration (“SZ Land Administration Law”) was issued on

³⁶⁴ Ibid.

³⁶⁵ Cao, Pei *Real Estate Law in China*, Hong Kong, Sweet & Maxwell 1998, 26.

³⁶⁶ Ibid

November 17, 1981, which was the first regional law for land administration in China.³⁶⁷ Under this law, the land use contract issued to land users only had rights of use, not title to the land. Therefore, the land user could not sell, lease or conclude other transactions relating to the land, such as exploiting the natural resources under the ground. These contracts were renewable when the term expired and the land use fees were reviewed every three years, with a possible increase of up to 30% over the previous year. One scholar argued that as the right of land use was under the supervision of the government in many respects and any further assignment was not allowed, the land use contract at this stage was in essence a license, not a lease.³⁶⁸

The Shenzhen land reform practice offered private enterprises and foreign enterprises the opportunity to obtain a plot of land for business use, thereby attracted many foreign investments from outside China into the SEZs. However, the piecemeal approach taken by the Shenzhen reform proved to be inadequate in satisfying the needs of land users. In particular, under the SZ Land Administration Law, land could only be issued to the land user through the administrative procedure of application and approval, and could not be sold or leased. These restrictions prohibited the development of land markets where commercial bidding of lands and the exchange of the rights of land use could be carried out.

In the first period, administrative forces, instead of market forces, drove the legal response to urban land market development. Understandably, at this stage of economic reform, as Shenzhen was a developing area with plenty of land available for investors, the implementation of the land reform policy by administrative means was easier in Shenzhen than in other areas.

³⁶⁷ Ibid, p.28.

³⁶⁸ Cao, Pei *Real Estate Law in China*, Hong Kong, Sweet & Maxwell 1998, 29.

In the second period, from 1987 to [1990], when the State Council chose 5 cities – Shenzhen, Guangzhou, Shanghai, Xiamen and Fuzhou – as pilot cities for further urban land reform, new policies had to be introduced to meet the new situations of these cities. Shanghai, in particular, was the largest industrial and commercial center of the five cities. The restrictions in limiting the marketability of land use rights had to be partially removed. The Shanghai Municipality Measures on Transferring Land Use Rights for Value (“Shanghai Measures”), enacted since January 1, 1988, made three important progresses from the previous stage in Shenzhen – namely (i) land was issued to land user not only through the administrative procedure of application and approval, but also through commercial measures such as bidding against others; (ii) land use rights include the right of gift, sublease and exchange for other property within the term of the land use contract; and (iii) land use rights could be mortgaged. This legal response represented an advancement of the concept of land use rights originally conceived in Shenzhen, whereby a right of license of the urban land was transformed into a right of lease through the new reform experiment in Shanghai.³⁶⁹

In the third period, from 1990 onwards, based on the Shanghai model, the Interim Regulations of the PRC on Granting and Transferring the Right to the Use of State-Owned Land in Cities and Towns (“the 1990 Regulations”) was enacted in 1990. The 1990 Regulations implemented the Shanghai model at the national level, though, arguably, the regulation was still short of a fully developed land market, as the legal relationship between the lessor (the state) and the lessee (the land user) that referred to both rights of license and rights of lease remained not clearly

³⁶⁹ *ibid*

defined by law.³⁷⁰ As urban real estate market developed and grew exponentially, particularly in the area of condominium development, property laws governing the distinctive ownership structure of condominium owners was badly needed. The 2007 Property Law of the PRC devoted chapter 6 to this subject matter, which provided that condominium owners enjoy exclusive ownership of their assigned exclusive component as well as co-ownership and common management rights to commonly owned property.³⁷¹

4.5 Summary

Land reform is a core reform program of any socialist economy. Land market reform which presumes a notion that land rights can be created and exchanged under market conditions is an even more important core reform program of the socialist economy.

While it has been shown that the notion of market systems is not contradictory to the socialist ideology, China's land market reform reveals the tensions caused by the contradiction among its socialist institutions. Nevertheless, the tensions in land market also served as the driving forces for the normative reform of the relevant institutions and the socialist ideology of the PRC.

Land use rights, rather than ownership rights, forms the basis for the land market development in China. Though to a certain degree, a right to land ownership is nothing more than the permanent establishment of land use rights. The land use rights reforms are iterative and evolutionary. But more importantly, these reforms are also normative. They are normative because the reforms have demonstrated a gradual transformation of the interpretation of

³⁷⁰ Cao, Pei *Real Estate Law in China*, Hong Kong, Sweet & Maxwell 1998, 30.

³⁷¹ Article 70, Property Law of the PRC, 2007

Chinese socialism. The notion of private ownership is one key component of this interpretation. But, unlike the concept of capital ownership of capital market reform, land ownership as a means of production attaches firmly to the socialist ideology of public responsibility and collective interest. Notwithstanding, the Chinese land market reform program of the last economic reform illustrates the evolving characteristics of Chinese socialism similar to the case of capital market. The historical account of the land use rights market signifies the socialist concept of property rights within the confine of public responsibility, collective interests, individual liberty, and economic utility.

Land ownership, land use rights and land market are fundamental features of land market reform programs in China. The study of the evolution of these constituents of land reform therefore offer insights into not only what are the driving forces of land market reform, but also into how will these forces shape the broader economic reform and socialist ideology in China.

The reforms have been placed into perspectives such that the relation between each successive iterative step of the reform can be understood. By doing so, the institutional methodology is applied to the land market reform to validate, and at the same time augment, the iterative theoretical framework as developed in Chapter 2 of this dissertation. Also, based on an historical account, it is seen how the concept of the household contract system, that was ideologically considered as the reverse of the socialist principle of collective farming and officially prohibited under the document of the Fourth Plenary Session of the Eleventh Central Committee of the CCP in September 1979,³⁷² was corrected by the policy statement of 1979 at

³⁷² The session adopted the “Decisions of the Central Committee of the Communist Party of China on Some Questions Concerning the Acceleration of Agricultural Development (Draft)”. The Draft was promulgated 9 months

the early stage of the economic reform. Further, it is also seen how the tension arising from such concept continued to drive land market reform and the subsequent economic decisions, as well as the corresponding legal and/or socio-political responses to such decisions, thereby illustrating an iterative process of the reform.

In this chapter, through the case study of land market reform, it is shown that the reformation of land use rights, the transferability of land use rights, the clarification of the legal nature and protection of land use rights are iterative and evolutionary. Not only is this iterative process incremental, gradual and evolutionary, but it is also progressive and advancing. However, it is difficult to identify what the ultimate destiny of the reform will be, as it is not explicit in the ideology itself. The iterative process however is underpinned by a self-corrective and self-improving culture, where a continuous tension arising from the socialist ideology of public responsibility, collective interest, individual liberty and economic utility will serve as the driving force of successive iterations.

This chapter recognizes the many shortcomings remaining in the land use rights reform, such as the insecurity of land use rights. It also reiterates the idea that ideological reform can be done when socio-economic conditions are favorable and that ideology alone is not sufficient to explain all institutional changes. This chapter also raises the question as to what guides these institutional changes over the course of the reform. In this chapter, it can be said that land market reform, while guided by pragmatics and other local conditions, yields to the force of socialism as far as the socialist characteristic of public ownership is concerned. The iterative

later by the Fourth Plenary Session of the CCP Central Committee in September 1979. For the text of the decision, see Editorial Board of China Agriculture Yearbook, *China Agriculture Yearbook 1980* Beijing, Agricultural Publishing Press, 56-62. The prohibition of the HRS was stipulated on p.58 of the above text.

changes of land ownership reform, though reflects the balancing acts of institutional contradictions, continue to adopt public ownership as the dominant form of ownership structure in the land market.

Finally, the interplays between the capitalist ideas of a market economy, including its building blocks of the property right infrastructure, and the socialist goals of capital and land reform programs can be compared and contrasted. Insofar as land ownership reform is concerned, the two reform programs take different paths. But, in respect of land use right reform, the two programs share a common path. In particular, the emergence of the socialist concept of property right for capital market and land market, taken together, is evidence to the assertion of the iterative theory of institutional changes to the extent that the development of property rights caused by capital market reform programs will influence the same by land market reform programs, and vice versa. Therefore, over the long run, it follows from the iterative theory that market reform and the evolution of property rights foster the evolution of the socialist concept of rule of law, albeit within the confines of the market economy. This latter point shall be examined from a normative perspective in the following chapter.

CHAPTER 5 NORMATIVE MODEL OF MARKET REFORM

5.1 Introduction

This chapter addresses the third concept of the thesis, namely, the interplay of the ideology of socialism, the local pragmatics of an open policy, self improvement, stability and efficacy, and that these will be conducive to the evolution of a rule of law based open yet controlled society over the long run.

Recall that in the discussion about norms that drive capital and land market reforms, I identified the self-correcting, self-improving, piecemeal, experimental, gradual, pragmatic, and iterative characteristics of local culture of Chinese socialism. This local culture represents only a subset of the norms, which are prevalent in the historical account of such institutional changes of capital and land markets in China. The historical approach, while useful in understanding certain normative behaviors of the change process, suffers inherent risks of seeking truth from the facts, which might have fostered an errant experimentalism as well as a displaced integrated jurisprudence.³⁷³ In particular, even though this part of the local culture does explain the facts of past capital and land market reforms, it is not clear whether the same will be applicable to future reforms. More importantly, in a broader context, even if it does, it is far from clear how these norms might be applied to institutions outside the sphere of capital and land markets, such as socio-political institutions of the PRC.

³⁷³ See Keith, Ronald C. and Zhqiu Lin *Law and Justice in China's New Marketplace* [city], Palgrave Macmillan 2001, 175

Nevertheless, the iterative theory of institutional change of Chinese socialism serves as a useful analytical tool in the inquiry of the subject matters. In this regard, I shall continue to expand the iterative theory to develop a normative perspective of institutional change of Chinese socialism, which not only identifies such norms, but also explain the relations among them.

From the literature, it can be seen that many scholars have studied these same questions concerning the underlying driving forces of the reform process. These studies examined the empirical evidence of the reforms and postulate the principles that guide such reforms. These studies either focused on the interplay process³⁷⁴ or on the underlying principles of the process.³⁷⁵ However, what remains unclear from these studies is how the process evolves and how norms are changed over time. Given that these changes are evolutionary and iterative, what will be the long run equilibrium, and what, if any, are the constants in successive iterations?

At the beginning of this dissertation, I argue that, as Chinese socialism is an evolving ideology, it is logical to inquire into the essence of the ideology. In other words, it is important to understand the invariant part, if any, of the evolving concept of Chinese socialism. Similarly, at the earlier part of this dissertation, I stress the adaptability characteristic of the ideology of Chinese socialism. The reason for making those assertions is that it is not meaningful to discuss long run equilibrium of a societal form that is transient in nature. Hence, given that the ideology of Chinese socialism is relevant in the long run, I can then attempt to develop a

³⁷⁴ See Potter, P.B. Legal Reforms in China – Institutions, Culture, and Selective Adaptation (Spring 2004) 2, no. 4 *Law & Social Inquiry* 465-495 and Lubman, Stanley B. *Bird in a Cage: Legal Reform in China After Mao* Stanford, Stanford University Press 1999

³⁷⁵ See Ramo, J.C. *The Beijing Consensus (2004)*, pp.11-12 and Peerenboom, Randall P. *China Modernizes: Threat to the West or Model for the Rest* New York, Oxford University Press 2007, 5

normative model that can help to discover the invariant characteristics of the ideology and answer some of the questions set out at the beginning of this chapter.

5.2 Normative Methodology

5.2.1 Institutional Perspective

In the context of capital market, I argue that the reform of capital ownership and market system have prompted legal responses that lead to the formulation of the concepts of property rights, legal person, and property rights of legal person. Similarly, in the context of land market, I argue that the reform of land use (rather than ownership) and market system have prompted legal responses that lead to the formulation of the concepts of land use rights, the transferability and protection of such rights of the rural land market. In both cases, I show that these legal concepts have advanced market reforms, including the development of property rights infrastructure.

But, I argue that the historical account of these developments is not sufficient for identifying the guiding principles that shape and drive market developments as well as the socialist ideology of the PRC. The difficulty is that historical account of events can be misleading. For one obvious reason; history only says what the thing was, but not what ought to be. For another less obvious reason, in the Chinese context, the pragmatic principle of “crossing the river by feeling the stones” may actually disguise unintended outcomes as consequences of a

normative goal, which is driven by an underlying unknown norm.³⁷⁶ In other words, in the context of private ownership reform, it cannot be sure whether the emergence of a pluralistic society is a goal of its own driven by an unknown norm or is merely an untended consequence of ownership reform guided by the principle of “crossing the river by feeling the stones”. From this perspective, norms derived from historical observation not only are inadequate but also risks being misrepresented.

To address these shortcomings, this chapter will revisit the subject matter from a purely normative perspective, as opposed to a mixture of historical and normative, by looking at the very basic notion of ownership and market institutions. Accordingly, based on these notions, the normative characteristics that explain what and how these institutions behave over the long run and what if any core values are invariable in these institutions will be examined. In this manner, core principles and values that guide and shape these socialist institutions over the long run will be articulated. In short, this approach focuses not on the historical context but on the normative perspective of the institutions instead.

5.2.2 Institutional Norms

In the previous chapters, I argue that, in the context of market reform, a property right infrastructure is at its core. Based on the traditional western concept of a property right infrastructure, I also argue that the concept of efficiency, fairness, stability and internationalization are basic norms of the market exchange institutions.

³⁷⁶Goldman Merle and Roderick MacFarquhar ‘Dynamic Economy, Decling Party-State’ in *The Paradox of China’s Post-Mao Reforms* (eds) by Merle Goldman and Roderick MacFarquhar Cambridge, Harvard University Press 1999, 3-29.

Accordingly, based on the notion of market as a rights based system, I argue that rule of law is implied as a core value of the socialist market economy of China. However, in the historical account of events of capital and land market reforms, rule of law is neither apparent nor implied. But, I argue that the new conception of property rights in the capital and land market signifies the early emergence of the socialist concept of rule of law within the confines of Chinese market economy, notwithstanding that one scholar has said that the development of Chinese property law has been one of the most confusing and disappointing chapters of contemporary legal development as it relates to the creation of a rule of law economy in China.³⁷⁷

From a historical perspective, the case studies of capital market and land market reform have demonstrated that when China adopted the market reform in the early stage of the contemporary economic reform, it was faced with the tensions created by the capitalist ideas of property rights in particular and the rule of law in general, against its traditional socialist ideologies. This same observation has been made by at least one scholar regarding such historical development of the Chinese concept of property rights.³⁷⁸

However, by conceiving market economy as a property right infrastructure, the theoretical truth is that rule of law must be a core ingredient of any market economies, capital and socialist included. Therefore, as and when China adopts market reform, it implicitly adopted one conception of property rights and rule of law as a new component of its socialist ideology. Though, it is not entirely inconceivable to propose that the Chinese concept of rule of law can

³⁷⁷ See Keith, Ronald C. and Zhiqiu Lin *Law and Justice in China's New Marketplace* New York, Palgrave 2001, 138

³⁷⁸ 'Law is a Cornerstone of Progress', China Daily, 22 August 1987, 4 cited in Keith Ronald C. *China's Struggle for the Rule of Law* New York, St. Martin's Press 1994, 6

carry a different content as the West. In the case study of capital market reform, insofar as ownership is concerned, Chinese pragmatics trumps the ideology of socialism and allows private ownership to emerge within the context of socialist ownership. In the case study of land market reform, however, the ideology of socialism prevails over local pragmatics and allows only a variant of land use rights, in lieu of land ownership rights, to meet the demands of local practice. In this sense, it can be said that Chinese socialism is neither entirely traditional socialist nor entirely locally pragmatic. Rather, it is a hybrid of both, simultaneously ideological and pragmatic, and is willing to innovate and experiment in accordance with contextual environments. In the context of rule of law, as opposed to ownership, it is entirely conceivable to speculate that the ideology of socialism will adapt a socialist variant of the concept of rule of law, by way of local pragmatics and other local conditions.

From the iterative perspective, as long as China's open door policy continues, the iterative theory of global movement will ensure that rule of law as a norm, albeit with local characteristics, will eventually be 'adapted from the Western institutions and 'internalized' into the socialist system of the PRC. Though, as the iteration does not say how the normative content of rule of law will be adapted and internalized, the concept of Chinese rule of law remains to be determined.

Generally speaking, the concept of the market as a property right infrastructure, which entails institutions and processes of rights delineation, trading process, and rights protection suggest that the norms of a market economy will be multi-faceted. Each institution and process arguably will be endowed with a set of norms unique to its own situations. Market in the

aggregate can therefore be conceived as a meta-norm in the sense that the aspiration of a market economy will subscribe to a bundling of a set of norms, such as market stability, process efficiency, property rights, etc.

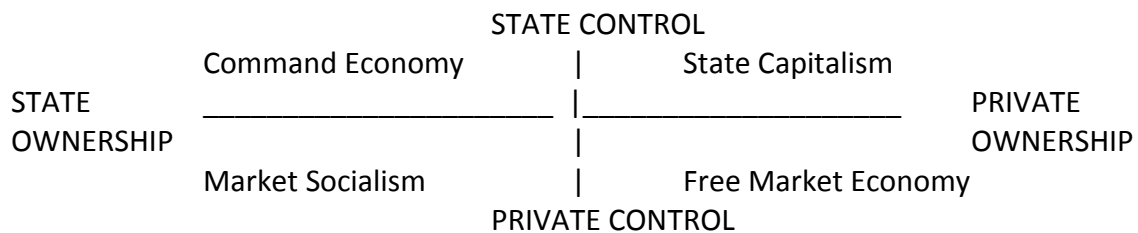
From a normative perspective, each of the constituent norms of market economy cannot logically be the driving force of economic reform because the norms are themselves derivatives of the market reform policy. That is, if there is no market reform, it is not certain whether these norms will still exist under the socialist system. Market reform, per se, as seen from the two case studies, arises in the context of open door policy and economic reform, guided by the ideology of socialism and local pragmatics. In other words, the norms of market stability, process efficiency, and property rights, etc. are usefully for postulating the future developments of market institutions in China, but from a normative perspective, the ultimate source of change that lies at the heart of all driving forces that prompted market reform remains rooted to socialist ideology and local pragmatics.

5.3 Market as Fallacy and Opportunity

Market as a meta-norm is now deeply entrenched into the Chinese ideology. While I argue that the norms for prompting the inception of market reform are associated with those of socialist ideology, local pragmatics, open policy and other reform goals, it is nevertheless useful to take market as given and attempt to study the normative content of China's so called "socialist market economy", alternatively called "market economy with Chinese characteristics".

5.3.1 Market Typology

Since market economy is originally a western concept, it follows that a normative study of the Chinese version of market economy shall be based on a comparative framework of socialist and capitalist market economies. One way to conduct this comparative study is to classify market economy by degrees of private ownership and state control. One typology of market economy is as follows:³⁷⁹



This diagram depicts a simplified view of the typology of modern economic systems. The horizontal axis, which shall be referred to as the ownership axis, is the distribution of property rights with increasing private ownership as one moves from left to right. The vertical axis, which shall be referred to as the control axis, is the control of the state with increasing autonomy of the economy as one moves from top to bottom. Therefore, the diagram depicts four quadrants. Moving in a clockwise direction, the lower left quadrant represents a command economy where state ownership and state control are both high. The upper left quadrant shows a market socialism economy where state ownership is high, but state control is

³⁷⁹ See Guo, S. The Ownership Reform in China: What direction and how far? (2003) 12, no. 36 *The Journal of Contemporary China* 553-573

low. The upper right quadrant depicts a state capitalism economy where private ownership and state control are both high. And finally, the lower right quadrant represents a laissez-faire market economy where private ownership is high and state control is low.

Depicted as such, the degree of private ownership and the degree of state control determine the type of economic system. In China, the future direction of economic reform, in respect of the normative content of its socialist market economy, is a function of the ideological values of private ownership and state control.

From the above, it is conceivable that China's socialist market economy represents a particular orientation of state control and private ownership in the four-quadrant typology of market economy. Along the ownership axis, the relative proportion of public ownership vs. private ownership is one distinguishing feature between socialism and capitalism. Traditional socialism, which does not recognize private ownership, therefore demonstrates economic system typical of those on the left hand side of the diagram, while capitalism which aspires to privatization adopts economic system typical of those on the right hand side of the diagram. Similarly, along the control axis, the role of the government and the extent of state control is also one distinguishing feature between socialism and capitalism. Traditional socialism aspires to the ideology whereby the State intervenes with the economic activities through central planning and regulation, which are typical of economic systems at the upper part of the diagram. Capitalism promotes decentralization of economic decisions and minimal regulation that are typical of economic systems at the lower part of the diagram.

Accordingly, the interplay between Chinese policies and global movement has caused the emergence and elevation of the private sector and civic society in China. This has shifted the orientation of China's market system towards the bottom-right quadrant. On the other hand, the outburst of the global financial crisis of the developed countries during the 2008-2009 periods has raised doubts about the conventional wisdom of no or little government intervention in economic activities and minimal market regulation and appears to favor a shift towards the top-left quadrant.

This is not to say, however, that socialist market economy and capitalist market economy will converge. The point to make here is that the distinction between socialist or capitalist market economies based on traditional typology is becoming blurred. Indeed, as I argue before, socialism as one orientation of societal form along the ideology spectrum can in fact embody capitalist as well as socialist values. It is not sufficient to understand market economies merely on a typology of the institutions of private ownership and state control. Instead, it is necessary to understand them from a full array of its constituent institutions. In other words, market economy, as a multi-dimensional array of constituent institutions, the normative understanding of a market economy can be conceived by way of the normative perspectives of the constituent institutions.

In the case studies, I observe that market is in essence an iterative process of change of the constituent property rights institutions. That is, market evolves as the rights delineation regime constituted by ownership and use institutions evolves or as the rights exchange regime constituted by administrative institutions evolves. As such, market evolves from one

orientation of these infrastructural institutions to another through normative and iterative evolutions. In this respect, the essence of a particular orientation of a market economy is defined by the constituent property rights institutions. The labels of 'socialist market' and 'capitalist market' are general terminologies rather than defining terms.

5.3.2 Fallacies

Indeed, as I shall argue, a normative perspective of market will review at least two important inherent fallacies of any market economies, inclusive of capitalist and socialist markets. One concerns with stability while the other concerns with efficiency.

Firstly, the fallacy of stability of a market economy lay in the fundamental assumption that markets are self-correcting and tend towards equilibrium. In Western economic theory, it is assumed that the common interest of the market economy is best served by allowing every market participant to look out for his or her own interest and that attempts to protect the common interest by collective decision making distort the market mechanism. In such formulation, the global economy is characterized not only by free trade in goods and services but even more by the free movement of capital. This implies that capital moves to wherever it is best rewarded. And, as capital movement is based on financial decisions about the future, a market system of this sort is inherently unstable. The reason is that, attempts to predict a future is contingent on the decisions of the people who are making the prediction in the present. That is, instead of just passively reflecting reality, capital markets are actively creating the reality that they, in turn, reflect, thereby creating a two-way connection between present

decisions and future events.³⁸⁰ From an iterative perspective, market equilibrium is achieved through an iterative process. At any point in time, demand, supply, and price levels are set, and over times are adjusted, and as these levels are set and adjusted, market will gradually move towards equilibrium. But, as each iterative step of market movement does not exist in isolation but, in reality, it is blended with reflexive behavior of market participants who are often flawed, market is constantly rendered by unstable forces into a quasi state of non-equilibrium.³⁸¹

Secondly, the fallacy of efficacy of market economy lay in its failure to achieve pareto optimal in the absence of government intervention. Classical Western economists, such as John Stuart Mill and Henry Sidgwick, conceived market failure in the context of externality,³⁸² although if parties can bargain without cost over the allocation of resources, then private market can always solve the problem of externalities, and can allocate resources efficiently, irrespective of how the law assigns damages.³⁸³ Contemporary economists tend to conceive market failure in a broader context. In certain situation, the term was used to refer to situations in allocation theory wherein a more or less idealized system of price-market institutions may fail to sustain desirable activities or to stop undesirable activities.³⁸⁴ In other cases, the term was used to refer to market failure scenarios where individuals' pursuit of pure self-interest leads to bad

³⁸⁰ See Soros, George *The Crisis of Global Capitalism* New York, Public Affairs 2000

³⁸¹ Ibid.

³⁸² See Medema Steven G. and Mill, Sidgwick, "The Evolution of the Theory of Market Failure" [Online], Working Paper (2004). Available from: www.utilitarian.net/sidgwick/about/2004070102.pdf. Notes: on externality: When our actions impact on those not directly involved, an externality exists. As one individual's behavior increases or decreases, another's satisfaction or profit changes as well. It can have a positive or negative effect on a third-party not directly involved with the buyer or seller of the transaction. These costs (benefits) are not included in the cost curve faced by the decision makers. The relationship between market failure and externality is that, with competition and no externalities, markets will allocate resources so as to maximize the surplus available. However, if these conditions are not met, markets may failure to achieve the optimal outcome.

³⁸³ See Coase, R. The Problem of Social Cost (1960) 3, no. 1 *Journal of Law and Economics* 1-44

³⁸⁴ See Baton, F.M. The Anatomy of Market Failure (August 1958) *Quarterly Journal of Economics* 351-379

results for society as a whole.³⁸⁵ Indeed, externality is only one type of situations where free market system may fail. Other situations such as market power, public goods, equity and macroeconomic stability are also cited as other causes of market failure.³⁸⁶

The two fallacies mentioned in the above are both inherent. In regard to the first type of fallacy, the source of the instability originates from the flawed reflexive behavior of the market participants. The obvious cure is to empower each market participant to behave as close to the equilibrium conditions as possible. In other words, from a market regulator's point of view, the cure is to improve the consciousness of the participants such that their behavior collectively will render the market to move towards the state of near-equilibrium. Such self-consciousness, taken collectively, equates to an imperfect society that is always open to improvement.³⁸⁷ In this respect, the notion of culture that cultivates self-improvement is not only an ideal goal of a society but is also a sufficient condition for market economy. In regard to the second type of fallacy, it is a well established economic theory that inherent deficiencies of free market systems can be remedied by the role of government whereby governments will write and enforce the rules of exchange in order for the market to function effectively. Government will also provide other public services such as road building, money standardization and so on that combine to facilitate exchange.

Notably, the two different types of market fallacies require two different approaches as remedial responses. Market inefficiency can be remedied through the use of market forces and government intervention. But, market instability, as an inherent fallacy, can only be minimized

³⁸⁵ See Krugman Paul R. and Robin Wells *Economics* New York, Worth Publishers 2009

³⁸⁶ Ibid.

³⁸⁷ See Soros, George *The Crisis of Global Capitalism* New York, Public Affairs 2000, 85

through a self-improvement culture of a society that recognizes its own fallibility and adopts an idea that constantly seeks to improve itself. The latter is notably more important as it represents a new order for market reform, which entails the bringing about of new cultural value that strives to uphold a self-conscious, self-improvement and self-correcting society.

5.3.3 Opportunities

In the earlier section, I argue that market itself is not the driving force of economic reform. Economic reform is conceived by the goals of improving the efficiency of the state sector and revitalizing the socialist economy. These goals are in essence the driving forces. Two socialist aspirations are at the heart of these driving forces. One is the open door policy and another is the economic efficiency. Both of these two socialist aspirations helped to drive the economic reform in general and market reform in particular.

Open door policy allowed global influences to interplay with the domestic institutions. In particular, open door policy has facilitated the introduction of the Western concept of market economy into the local system. Although the introduction of the market system is not a grand strategy, local pragmatics, by way of an iterative process, has nevertheless shaped and built a socialist market economy with Chinese characteristics. Further, based on the iterative process, once the notion of market is adopted into China's socialist ideology, it will become a catalyst of change itself and motivate further reform. In fact, market fallacies that exist under both socialist and capitalist systems are sources of such impetus of reform. The reason is that, as argued before, the iterations represent incremental steps as remedial measures to the deficiencies of the preceding iterations. Hence, China's imperfection in connection with the

inherent weakness of its market system is arguably a source of tension that constantly prompts for further reforms.

In a sense, both the negative and positive characteristics of a market system can be sources of power that drive further economic reforms. The negative weaknesses motivate reforms by way of the tensions that constantly prompt for further reform and constant strive for corrections, whereas the positive feature motivates reforms by way of a constant strive for improvement. For instance, as evidenced in the case studies of capital market reform and land market reform, market as a property right infrastructure has an inherent impetus to promote ownership rights and property rights. Consequently, it also has a natural tendency to promote the culture of fairness, justice, and openness, all of which are natural ingredients for the conception of the rule of law. Furthermore, as evidenced in the historical development of the PRC's property rights legislation of 2007, market as a property right infrastructure induces the ideal of equal protection of public, collective, and private property rights and, consequently, has an inherent tension between state supremacy and rule of law, all of which necessitates an aspiration of the legal culture of rule of law, albeit within the confine of the commitment to create an egalitarian society.

Therefore, if the iterative process of institutional reform can continue over a very long period, it is conceivable that the market as a meta-norm that encompass the concepts of individual liberty, economic utility, equal protection of property rights, internalization as a movement of open door policy, together with local pragmatics as a principle that reinforce the virtues of self-correction and self-improvement, then it is conceivable that China's socialist legal institution

will continue to shape itself and others towards such form that aspires the ideal of rule of law, albeit within the confine of the market systems.

5.4 Normative Forces of Economic Reform

From the above, it is argued that the instability of market economy and imperfection of political society are all catalysts of institutional reforms. In a local culture that is predisposed by self-correction and self-improvement, it seems that efficacy and stability are the natural economic goals aspired by the Chinese ideology. Indeed, it can be seen that efficacy as an economic goal is evidenced in the historical study of capital market reform and stability as a socio-political goal is evidenced in the same study of land market reform.

But, the norms that underpin the economic reform toward these goals and the goals that drive and motivate the reform are different matters. By that I mean, the norms are the intrinsic values that ought to be adhered by the Chinese ideology, such that the Chinese market economy and political society can advance from their inherent weaknesses or imperfections toward the twin goals of efficacy and stability.

In the West, it has long been argued that private sectors are more efficient than public sectors.³⁸⁸ The goal of efficacy is therefore a catalyst to the emergence of private enterprises of the market economy. Further, the concept of property rights has been taken as a major reform measure to improve efficiency in transition economies in recent years, on the ground that well-

³⁸⁸ See Hayek, F.A. "The Present State of the Debate" in *Collectivist Economic Planning: Critical Studies on Possibilities of Socialism*, edited with an Introduction and a Concluding Essay by F.A. Hayek, New York, Augustus M. Kelley 1935, 201-43 and Friedman, M. and R. Friedman *Free to Choose* New York and London, Harcourt Brace and Jovanovich 1980; Also see Lin Shuanglin "Resource Allocation and Economic Growth in China" in Lin, Shuanglin and Shunfeng Song (eds.)'s *The Revival of Private Enterprise in China* Hampshire, Ashgate Publishing Limited 1988, 34

defined property rights can serve as the basis for the proper functioning of markets as they provide incentive, stimulate competition, and engender the efficient use of resources, technology innovation and output growth in a world of scarcity.³⁸⁹ Notwithstanding, prior to the launch of the contemporary economic reform, under the so called “socialist reform”, private enterprises were seized by the communist government and turned into state enterprises in the 1950s since then private ownership had not been legal for the following 20 years in China.³⁹⁰ The re-emergence of the private sectors as a result of the market reform of the 1980s and 1990s must therefore represent a new interpretation of the ideology, which included a self consciousness that recognize imperfection and aspire to openness for improvement. This inclination to self-consciousness and aspiration to openness for improvement are evidenced in the economic reform policies in general and the capital market and land market reform policies in particular, which, in essence, are the most basic normative values causing the emergence of the private sectors and the related re-interpretation of Chinese socialism.

In the context of market reform, it can be said that efficacy is an economic driving force whereas self-consciousness, openness, self-correction and self-improvement are the basic ingredients underpinning the driving force. With that said, it can also be argued that, in theory, efficacy and stability are only means to an end. The socialist ideals are not efficacy and stability per se, because efficacy and stability are only relative concepts. Intuitively, it can be

³⁸⁹ Furubotn, E.G. and S. Pejovich “Property Rights and Economic Theory: A Survey of Recent Literature,” *Journal of Economic Literature* 10, 4 (1972) 1137-62

³⁹⁰ See Lin Shuanglin “Resource Allocation and Economic Growth in China” in Lin, Shuanglin and Shunfeng Song (eds.) *The Revival of Private Enterprise in China* Hampshire, Ashgate Publishing Limited 1988,35

understood that efficiency is a desirable economic goal, but, in essence, efficiency is necessarily tied to a relative measure of other goals or ideals. For example, the Chinese economic goal has often advocated GDP as the single measure of economic success, whereas alternatively GDP as well as quality of life, welfare level, environmental issues, and others are all relevant goals that are not premised on efficiency. Similarly, it can be understood that stability is a desirable economic, social and political goal but indeed stability is only desirable because there are certain more important goals or ideals that demand stability as a virtue.

By conceiving efficacy and stability as drivers, it is possible to raise questions such as what are the ultimate socialist goals or ideals aspired by Chinese socialism. I shall deal with these questions from a normative perspective in the following. In the discourse, I shall argue that, based on the notion that efficacy and stability are drivers of market reform, it is conceivable, in theory, that Chinese socialism will advance towards three normative goals, namely state control, open society, and rule of law. The reasons for such assertions are explained in the followings.

5.4.1 Efficacy as Driver for State Control

The first assertion is that the inherent drive for efficacy within a market system will lead to the aspiration of state control over the market system.

The reason is that, as evidenced in the historical study of land market reform in particular and as argued in the normative study of market system in general, market system has an inherent fallacy in relation to its efficacy. Such fallacy has an inherent tendency to prompt for government intervention and thereby aspires to state control. Government intervention

becomes a constant source of tension of market economy, because the state has to decide its role in dealing with issues such as market failures, macro-economic control, public services, externality, etc. From this perspective, the desire to improve efficacy of the market system is, in essence, a driving force that constantly shape constituent institutional reforms by way of government intervention. Specifically, efficacy as an impetus for fixing market failures, which existed in both capital market and land market of the Chinese market economy, are examples of institutional changes of the market economy that characterized state intervention.

In practice, notwithstanding the introduction of market reform, the Chinese government has continued to intervene in the operation of the socialist economy. Back in the 1980s, as economic reform commenced, China adopted a 'non-free' market economy, where government intervention to supplement market forces to shape and guide the economy was a norm rather than exception.³⁹¹ This is nothing surprising given that in most developing countries it is common for governments to take a large role in the economy whereby government imposed solutions take the place of market solutions.³⁹² As China transitioned from a planned economy to a market economy, it continued the role of government intervention and adopted a dual track transition strategy,³⁹³ whereby allocation decisions are made by both market and plan in the economic reform. In such model, the Chinese government adopted an administrative hierarchy to exercise control on the implementation of

³⁹¹See Naughton, Barry 'Market Economy, Hierarchy and Single-Party State Rule' in Kornai, Janos and Yingyi Qian (ed) *Market and Socialism: In light of the Experiences of China and Vietnam* New York, Palgrave Macmillan 2009

³⁹² Ibid., p.137

³⁹³ For a discussion on dual track system, see Qian, Y. "How Reform Worked in China", in Rodrik, Dani (ed.) *In Search of Prosperity: Analytic Narratives of Economic Growth* Princeton, NJ, Princeton University Press 293-333 and Naughton B. *The Chinese Economy: Transitions and Growth* Cambridge, MA, MIT Press 2007.

the dual track system at the early stage of the reform.³⁹⁴ This administrative hierarchy continues to survive until today, but operates on the unusually high-powered incentives. However, such administrative hierarchy is better suited to high-powered incentives that focus effort on easily measured indices such as GDP growth and is not so effective in dealing with the increasingly complex and multi-dimensional challenges that China faces as it moves to middle-income status.³⁹⁵

Therefore, the Chinese context of market efficacy encompasses an administrative-economic institution whereby macroeconomic control on the market economy will be exercised. In this regard, China's economic dual track system serves the function they were intended to serve when introduced, namely reinforcing Chinese government's commitment to the goals of its socialist regime. Such administrative-economic institution will encompass the power to use intervention tools, including taxation and subsidies³⁹⁶, public sector production³⁹⁷, antitrust legislation³⁹⁸, and regulation³⁹⁹ that are familiar and compatible with any market economy, West and East alike. Interestingly, it is noted that in the aftermath of global financial crisis of 2008-2009, developed countries advocated more stringent regulation on financial sector and

³⁹⁴ Supra 205, p.150

³⁹⁵ Ibid., p.159

³⁹⁶ Notes: Governments have the power to tax and subsidize. If government taxes certain behavior, it discourages it. If it subsidizes other behaviors it encourages it.

³⁹⁷ Notes: Governments can also choose to produce an item independent of the market.

³⁹⁸ Notes: By using trust laws, industries set up trusts where a stockholder in an individual firm could exchange their stock for trust certificates in an industry wide trust. When the trust obtained controlling interest in most of the firms in an industry it could effectively manage that market like a monopoly.

³⁹⁹ Notes: Governments can also pass laws and regulations that require businesses and individuals to behave in certain ways. Economics divides regulations into two types, social and economic. Economic regulations are those laws which are directed towards trying to maintain relatively competitive markets. Social regulations are those laws that regulate other behaviors of individuals and firms.

entrust more power to market regulators, which seems to support the idea of increased government intervention.

It is contended, in the context of market reform, macro-economic control by the government is justified on the ground of efficacy, though it is not directly obvious whether and to what extent other forms of non-economic control of the political economy, such as in the context of legal reform, may be justified on efficacy grounds.

5.4.2 Stability as Driver for Open Culture

The second assertion is that the inherent drive for stability within market system will lead to an aspiration of openness within the market system and an open culture within the political economy.

Notably, the open door policy has prompted the inflow of foreign investment and technology at the early stage of the economic reform. Unintentionally, the open door policy has also allowed the ideology of global capitalism to shape and influence local culture of the Chinese political society. It is contended that the principle of open door policy is embedded with the concept of 'openness', which by its very nature includes a self-consciousness that recognizes its own fallibility. The open door policy also implies a concept of 'internationalization', which exposes local conditions to an international worldview. Both the openness attitude of market participants and the internationalization exposure of local conditions are preconditions for the remedy of the inherent weakness of market instability as the openness attitude of market participants can help to recognize the market system's own inherent risk and the constant exposure of the local condition to worldviews can help to improve the local conditions including

the market participants so as to advance the overall market towards a state of near equilibrium.⁴⁰⁰

The historical account of Chinese capital market reform has demonstrated the interplay between global capitalism and local culture. From a normative perspective, it follows that the interplay must be guided by an aspiration of open attitude that constantly seek improvement through consciousness of self-criticism and reaching out for international experience. In this sense, one of the new orders for market reform ought to be local cultural reform that is to be characterized as one of the socio-economic ideas of Chinese socialism.

Based on an open culture, an open society can be conceived as one which ensures that political leaders can be overthrown without the need for bloodshed, as opposed to a closed society, in which a bloody revolution is needed to change the leaders⁴⁰¹ In the case study of capital market reform, it is evinced that the open door policy of economic reform has achieved the unintended consequence of the introduction of an open culture, which prompted the introduction and adaptation of the capitalist ingredients of a market system, such as private enterprises and property rights. As open culture of market participants will ensure that the Chinese economy will be opened to alternative views in future economic reform, it is conceivable that the ideas of a open society will be adapted into parts of the political economy in the long run. In other words, theoretically, the open culture of the market participants can over time shape the local culture so that the government shall be responsive and tolerant, and political mechanisms are transparent and flexible not only in dealing with market matters but also in other non-

⁴⁰⁰ See Soros, George *The Crisis of Global Capitalism* New York, Public Affairs 2000, 85

⁴⁰¹ See Popper, K. *The Open Society and its Enemies*, Vol. 1 and 2

economic policies. At that stage of Chinese socialism, the state keeps no secrets from itself in the public sense and the society at large is a non-authoritarian society in which all are trusted with the knowledge of all with political freedoms and human rights as foundation. This ultimate equilibrium of the political economy is achievable if the iterative process of institutional change can continue indefinitely. Furthermore, since individuals who engage in market exchange are primarily acting on their own self-interest and as political forces which are, in essence, groups of individuals trying to force other individuals to behave in certain ways that further the interests of those groups, the long run equilibrium is conditional on an open culture that is flourished through harmonious interplays of political forces and market forces. Conversely speaking, provided that an open culture is intrinsic to the iterative process, the conflict between market forces and political forces will necessarily demand an openness attitude that aspires to self-improvement and thereby to making the right choice.

Undoubtedly, China is at a state that is far from the idea of an open culture. It is also not clear how and when the open culture of the economic institution will spread to other social and political institutions of the PRC. In particular, it remains to be seen how and when the local culture of self-correction and self-improvement can advance the 'non-openness' barrier of the legacy institutions of the authoritarian one-party political system of Chinese socialism.

5.4.3 Property Rights as Driver for Rule of Law

The third assertion is that the intrinsic character of property rights delineation and protection of market system will lead to the aspiration of rule of law, initially limited to the confines of the market system but gradually spread over to other parts outside of the market economy.

The reasons are twofold. Firstly, the emergence of market economy will bring about the new order of property right, which aspires to equal protection of public, collective, and private property rights. And, secondly, the notion of equal protection of all forms of property right is contingent on the notion of rule of law whereby the society-at-large, including the state and local governments, are all treated equally before the law. It therefore follows from the iterative theory that rule of law will inevitably emerge in China in the long run, provided that the iterative process can continue for an indefinite period of time and the interplays between state control and individual liberty of property rights can be achieved through a harmonious manner.

Notwithstanding the above, even though it is conceivable that market reforms and the evolution of property rights foster the evolution of rule of law, it remains unclear how and what kind of rule of law emerges in the end. In order to discern with the last question, I shall first examine whether rule of law is a universal concept and whether the rule of law bears the same meaning under socialist or capitalist ideologies. The importance of this inquiry is that if the rule of law is not a universal concept, then it can be argued that the concept of the rule of law in China may not be the same as those of the West.

To start with, from a functional point of view, it is often said that the conception of rule of law shall carry a consensus meaning that it should be universal.⁴⁰² In such conception, the rule of law is a system in which law is able to impose meaningful restraints on the state and individual members of the ruling elite, as captured in the notion of a government of laws, the supremacy of law, and equality of all before the law, and therefore, in its normative sense, rule of law

⁴⁰²Peerenboom Randall P.*China's Long March Towards Rule of Law* Cambridge, Cambridge University Press 2002

bears the same meaning under socialism or capitalism, as well as under socialist market and capitalist market.

Indeed, as one scholar argues that, if the rule of law system is conceived as a thin component and a thick component, where the thin system stresses on its formal or instrumental aspects (those features that any legal system allegedly must possess to function effectively as a system of laws, regardless of whether the legal system is part of a democratic or non-democratic society, capitalist or socialist, liberal or theocratic) and the thick system covers the thin system and elements of political morality such as economic arrangements (e.g. free market vs. central planning, political form of government such as democratic capitalism vs. single party socialist, or conception of human rights such as liberalism, communitarian, Asian values, etc.), then the thin theory of rule of law offers a universal meaning to the conception of rule of law.

From the above, it follows that the notion of rule of law in socialism and capitalism can be reconcilable in that a socialist state would endorse a state-centered socialist rule of law defined by a socialist form of economy and an interpretation of rights that emphasize stability, collective rights over individual rights, and subsistence as the basic right rather than civil and political rights. A capitalist state would endorse a civic-centered democratic rule of law defined by a capitalist form of economy and rights that emphasize individualism, liberalism and human rights.⁴⁰³

By focusing on the minimum content of rule of law, the thin theory of rule of law suggests that whether a particular legal regime is compatible with the notion of rule of law does not depend

⁴⁰³Ibid.,pp.1-54

on the orientation of the regime's political morality, but rather is rooted to the legal regime's ability to impose limits on the party-state. In other words, theoretically speaking, Chinese socialism does not necessarily preclude a formal adoption of rule of law into its legal system merely on grounds of its political morality.

However, from a practical point of view, the thin argument is flawed because the thin rule of law does not exist in a vacuum. The implementation of the minimum content of rule of law must necessarily carry with it certain political morality. Hence, while the thin theory is a useful benchmark, the crux of the matter lay in the thick theory of the rule of law. Therefore, the question is how, in practice, can the rule of law be implemented and what does, in reality, the rule of law entail under the evolving ideology of Chinese socialism.

Intuitively, the concept of rule of law is the principle that every person, regardless of their rank, status or office, is subject to the same law and the same legal and judicial processes. In simple words, it means that just as citizens must obey the law, so must government. With rule of law, the legality of actions and fair procedures of the executive arm of government may be ensured. This ideal of the concept of rule of law is ancient.

Indeed, Professor A.V. Dicey developed the notion of the rule of law as far back as 1885 in his text, *The Law of the Constitution*. He argued that the rule of law is comprised of three inter-linked ideas: (1) the supremacy of regular law rather than arbitrary power,⁴⁰⁴ (2) government

⁴⁰⁴ Notes: governments cannot exercise arbitrary power through secret, arbitrary or retrospective laws, and no one can be punished except for conduct that represents a clear breach of law, established in the ordinary legal manner before the ordinary legal courts of the land.

under the law and equality before the law,⁴⁰⁵ and (3) the protection of individual liberties by the common law.⁴⁰⁶ While Dicey's formulation remains influential, the concept of rule of law has remained controversial since its inception. It means different things to different people.⁴⁰⁷

Among modern legal theorists, the three major views that are widely discussed are the formal approach, the substantive approach, and the functional approach.⁴⁰⁸ Without digressing into these approaches, suffice it to say that each of these approaches has drawbacks. For example, in a formal approach, which depends on formal criteria as definitions, the objectivity of the approach becomes illusory, as the formal criteria are selected through subjective assumptions about the actual effect of the rules in questions. In a substantive approach, in what is driven by a moral vision of an ideal legal system, the determination of how just a particular legal order is a subjective judgment. It is conceivable that there could be a society with unjust laws, or no laws at all, and yet such society has achieved substantive justice according to the normative criteria selected. In the functional approach, which focuses on how well the law and legal system perform certain functions, it is hard to make any definitive statement about the level of rule of law in a whole society as measured against these functions.

Therefore, in all of the approaches, whether it is a formal, function or substantive approach, or a hybrid of thin and thick theory, the concept of rule of law has inherent weakness. In the

⁴⁰⁵ Notes: there is a consistent application of the law and legal processes regardless of position or status, and ministers of state and government officials are subject to the law and accountable for their actions before the ordinary courts of the land.

⁴⁰⁶ Notes: free access to the courts of justice is a sufficient guarantee for civil liberties and against injustice.

⁴⁰⁷ Tamanaha, B. "The Rule of Law for Everyone" [Online], Legal Studies Research Paper, New York: St. John's University – School of Law 2002. Available from: SSRN: <http://ssrn.com/abstract=312622> or DOI:10.2139/ssrn.312622.

⁴⁰⁸ Stephenson, M. "Rule of Law as a Global Development" [Online], World Bank Research 2008. Available from: <http://go.worldbank.org/DZET85MD0>.

Chinese context, the notion of rule of law suffers two more drawbacks. One is structural and another is ideological. Structurally speaking, the concept of rule of law is premised on a degree of separation between law and politics, but law and politics are often intermingled in the Chinese context. For example, the judicial decision process in the Chinese courts is supervised and influenced by the Political and Legislative Affairs Committee of the Central Committee of the CCP. Ideologically speaking, the concept of rule of law assumes minimum contents such as to restrain government's arbitrary power. However, China's interpretation of the rule of law is characterized by its role as an instrument for the government. For instance, under Article 5 of the Chinese Constitution, it is stipulated that the Chinese government is required to rule the country according to law (依法治国). This provision suggests that the government shall follow the law in the performance of the governance of the country and the citizens. It is not clear whether the Chinese interpretation of rule according to law is a concept of government's rule by law or rule of law. It should be pointed out that evidence of the Chinese conception of rule by law as rule of law is found in its White Paper of 2008.⁴⁰⁹ Notably, the White Paper adopted the term 'rule of law' throughout the text and stated that Chinese people are comprehensively implementing the rule of law as a fundamental principle and speeding up the building of a socialist country under the rule of law.⁴¹⁰ But, the White Paper went on to suggest that the rule of law is understood to be a fundamental principle as well as the common understanding of all sectors of society to govern the country according to law and build a socialist country under the rule of law. As such, the White Paper appears to interpret rule of law in two contexts, one

⁴⁰⁹ State Council Information Office *"China's Efforts and Achievements in Promoting the Rule of Law"* (White Paper) 2008 available in www.china.org.cn/government/news/2008-02/28/content_1102548

⁴¹⁰ Ibid., p.2

concerning the governance of the country and another of the building of the society at large, both of which are not necessarily reconcilable. Further, it qualified the concept of rule of law as a socialist idea, stating that fairness and justice is a value to be pursued, but serving overall interests is an important mission and that the leadership of the CCP is a fundamental guarantee. The White Paper follows the traditional line to suggest that the Chinese legal system is a socialist legal system with Chinese characteristics, and is advocating a version of a rule of law that may be properly referred to as the “Rule of Law with Chinese Characteristics”. The White Paper went on to say that in recent years the Chinese government has transformed its functions and stepped up building a government under the rule of law by strengthening its self-improvement by establishing more public emergency response mechanisms, by making government information more open and available to the public, and by enforcing the administrative accountability system.⁴¹¹ But, the White Paper did not elaborate on the details of the said transformation and failed to address the fundamental issues such as judicial independence in general, and the non-interference of politics with law in particular. In the premises, the White Paper not only is unclear about its ideological interpretation of rule of law that can be reconciled with the minimum content of the concept of rule of law but has also failed to provide a framework of its own to address the weakness of the concept of rule of law and an institutional structure that will safeguard the interference of law by politics.

Notwithstanding, as rule of law is a concept that arises under the context of market economy, it can be expected that the new order of property rights as a part of the overall effort of market reform will continue to shape and drive the development of rule of law in China. The tension in

⁴¹¹ Ibid., p.6

the normative meaning of rule of law will continue to be a driving force in shaping legal and political reforms and thereby generating new economic and social situations in an iterative manner. In this respect, while rule of law is only premised on the limited role of serving the market economy, it will nevertheless be a driving force in shaping the legal institutions in a broad context as well as the political society at large over times. In this respect, based on the iterative theory of institutional changes, market reform and evolution of property rights are catalysts to the emergence of the concept of rule of law and will in the long run shape and foster the evolution of rule of law within the context of Chinese socialism.

5.5 Summary

Despite the significant impact that market reform has made to the ideology of Chinese socialism, a market system is inherently flawed in several aspects. However, such fallacies are better conceived as opportunities. The tensions created by these fallacies can serve as catalysts for further economic reforms. The awareness of these fallacies has therefore led to strive for the twin goals of efficacy and stability of market system. On the other hand, a market system can be conceived as a property rights infrastructure. Such market system has an intrinsic character that aspires to equal protection of property rights for all market participants and therefore foster the evolution of rule of law within the market system.

The positive character and the negative weakness of market system together helped to foster three ideals, namely state control, open society and rule of law. In relation to openness, the argument is premised on a culture that constantly seeks improvement to its own fallacies. As market system has inherent instability, the awareness of this fallacy is a catalyst that prompts

for a continuous effort to improve China's imperfect society through self-improvement and self-correction. The concept of 'openness' as a norm is a driving force of reform as well as an object of reform. By way of the iterative process, the open door policy has expanded its initial scope of foreign trade and investment to encompass capital and land market activities. It is conceivable that the open culture will continue to expand into other non-economic institutions with the ideals of an open society will gradually be adapted into various parts of the Chinese political economy.

Market reform, as an institutional reform in the property rights infrastructure, will foster the evolution of rule of law in China. The tension in the definition of the normative content of rule of law is a driving force of the legal reform and other institutional reforms. Though, such rule of law system is limited in application as it is conceived entirely within the ambits of a market system. It is conceivable that the concept itself will be advanced and will be internalized as a popular culture of the political society through an iterative process.

These normative forces have trumped traditional socialist ideologies over the course of the economic reforms. They are essentially "seeds" of socialist reform because they are often conceived in the context of a small-scale reform policy with limited application. These seeds have since grown into significant normative forces that will continue to carry the reform process.

Based on the iterative model, it is contended that these normative forces will inevitably bring about in the long run a rule of law based open society in China. But, as devils are always in the

details, there will be obstacles in the process. I shall discuss these obstacles in the next concluding chapter.

CHAPTER 6 CONCLUSION

6.1 Interpretation of Chinese Socialism

Socialism is an evolving ideology and has multiple interpretations. Each interpretation is a manifestation of the socialist ideology in some particular form of political morality. Different political orientations of the socialist ideology existed in reality. Chinese socialism, which is predominantly characterized by state control and public ownership, along with private ownership and market economy, is just one of the many orientations of the so-called socialist systems.

In this formulation, Chinese socialism is, on one hand, an ideology of socialism that aspires to the traditional socialist values of state control, public ownership, central planning, and egalitarian rhetoric, and on the other hand, a pragmatic doctrine that does not believe in uniform solutions for every situation and aspires to a ruthless willingness to innovate and experiment. The pragmatic doctrine is said to be the 'Chinese characteristics' of socialism in modern China. Under this notion of 'Chinese characteristics', socialist values of state control, public ownership, central planning, and rhetoric ideals are constantly shaped by the scrutiny of local pragmatics of modern Chinese reform. In the case studies of capital and land markets in Chapter 3 and 4 respectively, it is shown that Chinese socialism is willing to innovate and experiment new ideas beyond the confines of traditional socialism, and is willing to adapt new ideas, including capitalist ideas to local condition.

Naturally, the adaptation of capitalist ideas to Chinese socialism causes inherent conflicts of those capitalist and socialist values and creates tensions among the constituent institutions. But, I argue that these tensions are indeed driving forces of ongoing institutional reforms, which are an iterative process of advancing economic, legal, social and political change. The advancement of the institutions shapes and is also being shaped by the ideology of Chinese socialism. In China, the economic reform of the last three decades is one instance of such an iterative process.

6.2 Local Characteristics of Chinese Socialism

One important question that follows from the iterative framework is that: If the ideology is itself evolving and adaptable, then what in essence is the ideology? In other words, if Chinese economics can render traditional socialist content obsolete, can it be said that the ideology itself does not matter in shaping economic reform as well as in a broader context legal and socio-political reforms? I argue that, theoretically, although Chinese socialism is an evolving and adaptable ideology, the ideology however maintains some basic virtues, which guide the reforms of the socialist institutions in modern China. The spirit of local pragmatics articulated by the metaphor “crossing the river by feeling the stones” is one such basic virtue of Chinese socialism. Arguably, the local doctrine of pragmatics is one of the basic virtues that stayed constant during the entire course of the economic reform in the past three decades.

Consequently, if some basic socialist virtues did indeed stay constant in the process, why did they stay constant and why did other virtues evolve? How will the ideology evolve in a normative sense going forward? From a different perspective, will an evolving ideology

eventually converge into certain implicit socialist virtues in the long run? Moreover, what are the relations between these underlying virtues or norms that shape the evolution of the ideology of Chinese socialism?

To address these questions, I undertake three separate but related discourses.

6.2.1 Interplay of Socialist Ideology and Local Pragmatics

Firstly, I developed an institutional framework in which Chinese socialism is composed of three basic institutions: namely socialist democracy, socialist market economy, and socialist legal system. I argue that an iterative process can explain the evolution of these socialist institutions. The process is normative in the sense that the interplay between the constituent institutions is normative in nature. The interplays are conceived as dynamics between socialist ideology and local pragmatics. Specifically, the interplays are caused by the pragmatic mandates, such as open policy, self-improvement, stability and efficacy, as well as global capitalist movements in the early stage of the reform and world economic rebalancing in the aftermath of the global financial crisis of 2009. In particular, the open door policy adopted by the economic reform, together with the local pragmatics, has resulted in the introduction of market reform and private ownership reform. These reforms resulted in the adaptation of capitalist ideas and “advanced” the ideology of Chinese socialism.

6.2.2 Case Studies of Local Pragmatics

Secondly, I conducted two case studies where I demonstrate the practicality of Chinese reforms by way of a historical account of legal developments of capital and land markets. Through the

case studies, I showed that the practicality of pragmatic reform, open policy, self-improvement, stability and efficacy, along with the ideological commitment to state control, public ownership, central planning and egalitarian rhetoric, are the key ingredients that shape Chinese reforms. In the case studies, I also revealed that Chinese pragmatics are capable of trumping socialist ideology, at times, and Chinese socialism is neither entirely ideological nor entirely pragmatic, but is both ideological and pragmatic at the same time. Below is a summary of the local pragmatics identified in the case studies.

a) Pragmatic Reform

Capital and land market reforms offer concrete evidence of the pragmatic aspect of institutional reforms of modern China. The development of property rights, property rights of a legal person, and property rights infrastructure, that comprises of institutions and processes of rights delineation, trading process, and rights protection are examples. Similar examples are found in the development of the legal concept of land use rights, the transferability and legal protection of such rights.

The case studies illustrated the dynamic adaptation of capital and land markets to the PRC, by way of interplays between socialism and Chinese pragmatics. In the discourse, notwithstanding the inherent conflicts between capitalist and socialist values, China's capital and land market reforms continue to aspire to the spirit of seeking truth from the facts. Indeed, it also aspires to the adoption of a pragmatic approach to resolve these conflicts by way of novel ideas, thereby advancing the confines of the legacy ideology iteratively and normatively. In the discourse, I

also show that pragmatic economic policy can, at times, trump traditional ideology constraints. China's socialist ideology is a force of the reform as well as an object of the reform itself.

b) Self Improvement

Another local characteristic of the iterative process is self-improvement. It is essentially a kind of self-consciousness that is willing to recognize its inherent fallacies and open up to the aspiration of self-correction and self-improvement. With self-improvement as a local characteristic of the socialist ideology, the iterative process of institutional change guarantees that each step represents an advancement of the ideological reform. Without such characteristic, an iterative step can still proceed but the iterations may not necessarily drive the ideological reform to its desired goals.

From a historical account of capital and land market reforms of the case studies, Chinese socialism has consistently demonstrated an inclination to aspire to the normative virtues of self-correction and self-improvement.

b) Openness

In this dissertation, open door policy which leads to market reform and the evolution of property rights has been identified as the most important driver for the economic reform of the last three decades. I argue that the open door policy envisaged at the beginning of the economic reform has caused the internalization of the open culture as a normative value of the ideology of Chinese socialism.

China's accession to the WTO and the subsequent internationalization of its capital market are derivatives of the local-global interplays whereby foreign competitors are encouraged to enter into the Chinese economy. Such internationalization of economic reform will prompt further local-global interplays in the regulatory institutions as well as other socio-political institutions in the PRC.

The open door policy explains the inception of market reform, and the subsequent property right reforms. The open door policy is a key ingredient to the ultimate goal of an open society of Chinese socialism. Market reform in particular, which caused efficacy, stability, and property rights to emerge as functional goals, has long term consequence to the normative interpretation of Chinese socialism.

c) Efficacy and Stability

In the context of economic reform, this dissertation has also demonstrated that efficacy and stability are two functional goals that naturally arise as a consequence of market reform in the PRC. It is shown that efficacy not only drives economic reform per se, but also drives legal reform of Chinese socialism, as it explains the drive towards private enterprise and ownership reforms.

I argue that the inherent weaknesses of market economy, namely the weakness of inefficiency and instability, are constant source of tensions of China's economic institutions. These tensions are opportunities for further economic reforms. In respect to the weakness of inefficiency related to the role of the government, efficacy as a socialist goal will drive the administrative reform of the government. The administrative bureau of China's dual track market system is a

derivative of the tension and interplay between the socialist value of central planning and the aspiration of capitalist market system.

In respect to the weakness of instability related to reflexive behavior of market participants, stability as a socialist goal will further drive reform of the political economy.

6.2.3 Normative Analysis of Local Pragmatics

Thirdly, I attempted to build a model whereby I can study the normative characteristics of the interplay of ideological and pragmatic components of Chinese socialism. I conclude that local pragmatic and open door policy, as external mandates at the beginning of the latest economic reform, triggered an irreversible iterative process. Local pragmatics and open policy have caused the adaptation of market economy and private enterprise into China's political economy. In a way, when such idea of market economy is adapted into China's political economy, market conceived as a meta-norm of property rights, including the delineation, trading and protection of property rights, has caused fundamental change to the ideology of Chinese socialism.

The market, as a property right institution, will necessarily drive ownership reforms in the socialist ideology. The tension between the traditional public ownership of socialism and the new circumstances of market economy has prompted for the long iteration of capital ownership reform. In the end, China's traditional socialist value is partially trumped by the new economic relations of market economy. I argue that property right reform is merely an interim iteration because the market as a property right infrastructure will be a driving force in promoting the concept of equal protection of public, collective and private property rights.

From a historical account of the property rights law of 2007, China has demonstrated that the

concept of equal protection of all forms of property rights is at the core of the legal reform of its market economy.

To evolve from property rights development to rule of law, will require deeper and broader interplays between the market institutions and other non-market institutions of the Chinese political economy. This dissertation is primarily concerned with the study of the market economy. Further research is required to examine the interplay between market institutions and non-market institutions as far as the normative goals of rule of law and open society are concerned. Nevertheless, in the context of market reform, the case studies of capital market reform and land market reform have demonstrated that the norms of one institution can influence those of the other institutions of the Chinese socialist system. As evidenced in the adaptation of the capitalist idea of equal protection of public and private property rights in the capital market reform and land market reform.

Notwithstanding, in order to ensure that the ideological reform converges to this long run equilibrium, the socialist ideology must continue to aspire to the pragmatics of open door policy, self-correction and self-improvement, stability and efficacy goals. However, these local characteristics that are ingredients to the success of Chinese reform and prospect of long run convergence towards rule of law and open culture are not apparent or intrinsic in the ideology of Chinese socialism. On the contrary, it can be said that pragmatic reform, open policy, self-improvement, stability and efficacy are all external mandates advocated by Chinese reform policy makers and are subject to external influences. The obstacles ahead of future economic reform as well as political reform can therefore be described in several aspects, as follows.

a) Political Reform

This dissertation is concerned with the study of the regulatory reform of capital and land markets in the context of the contemporary economic reform of the PRC. As demonstrated in the iterative process of these institutional changes, the evolution of the institutions is gradual and incremental, and requires a long period of political stability and ruling legitimacy.

The iterative process will be interrupted or even terminated if socialist China is not able to conduct a political reform that aspires to long-term political stability as well as achieves long term ruling legitimacy.

Conceivably, these obstacles can be overcome if socialist goals of efficacy, stability and open door policy can be transpired into the context of political reforms. Though, further research is required, by transforming the application of the iterative model from the market economy to political economy of the PRC. Such study will shed light on the future development of the democratic, human right and civil right institutions of the PRC.

b) Legal Reform

Similarly, China's legal reform has been mainly conceived as a response to economic reform. While legal reform does not suffer the same risk as political reform in the sense that its limited scope does not fundamentally jeopardize the continuation of the economic reform, it is conceivable that incremental, piecemeal and evolutionary legal reform limited to the sphere of economic applications will be subject to increasing tensions in the sphere of socio-legal issues, such as human rights and civil liberties.

Just as the obstacles of political instability and ruling legitimacy may suffocate the iteration process of institutional change, the obstacles of legal reform beyond the scope of economic applications such as social movements toward human rights and civil liberties will have the same effect in undermining the iterative process of institutional change.

The remedy, as argued in the previous section, is to commence legal reform in its own context. That is, legal reform needs to be a response, not only to economic reform, but also a deliberation of its own. In this regard, the articulation of the socialist goals of efficacy, stability and open door policy, and the new order of property rights and rule of law, are all relevant. It is conceivable that the iterative analysis of legal reforms will divulge norms unique to legal institutions.

c) Social Reform

Economic reform, measured in aggregate terms, has largely been successful. Yet, China remains a poor country measured on a 'per capita' basis. Economic reform, without the parallel check and balance of legal and political reform, has exposed the Chinese society to serious corruption problems. Moreover, social stability as a socialist goal has rendered overall economic growth as the primary objective of economic reform. Such overall growth is not necessarily equitable to all segments of the political society. Most importantly, such growth rate may be not sustainable in the long run. If social reform is not able to develop a pace adequately fast enough to maintain social stability, then any slowdown of the overall growth rate will undermine the normal operation of the iterative process of institutional changes in

China. The remedy, as in the case of legal and political reforms, is that social reform need be contemplated in parallel with economic reform, but not as a response to economic reform.

6.3 Further Remarks

This dissertation advocates an iterative theory that explains ideological reform of Chinese socialism. Based on the experience learnt from the regulatory reform of capital and land market reforms, it is argued that the iterative process of institutional change will eventually lead to an equilibrium state where Chinese socialism will aspire to a rule of law, open and control based socialist society. The argument is based on a normative model, which conceives stability and efficacy as well as open door policy and property rights as the driving forces.

Together with the pragmatic principle, self-correction and self-improvement, the ideological reform will iteratively and normatively evolve towards the equilibrium state in the long run.

However, the iterative framework is at best a theoretical analysis. As such, one must recognize the limitation of the theory. The obstacles of political instability, ruling legitimacy, legal tensions in human rights and civil liberties, as well as social instability due to a slow down in economic growth are all risks and limits associated with the theoretical model. Each of these obstacles has the threat to suffocate the iterative process long before Chinese socialism can reach its equilibrium. Therefore, the theoretical assertions, beyond the sphere of market economy of Chinese socialism are subject to these obstacles and threats, which remain as major challenges to future reforms of the Chinese socialist regime.

Nevertheless, from the findings of this dissertation, it is conceivable that the remedy to avoid such risks and to overcome the obstacles is to entrench the normative virtues and socialist ideals of the fundamental ingredients of Chinese socialism outlined in the normative model of Chinese socialism. In this regard, it is suggested that further research on the application of the iterative theory to labour market reform and non-economic reforms including political social and legal reforms, should be conducted.

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