

The Institutional Dynamics of China's Great Transformation

Edited by
Xiaoming Huang



China Policy Series

The Institutional Dynamics of China's Great Transformation

This book examines the role of institutions in China's recent large-scale economic, social and political transformation. The book argues that, although the importance of institutions in China's rapid economic growth and social development over the past 30 years is widely acknowledged, exactly how institutions affect changes in particular national and historical settings is less well understood. Unlike existing literature, it offers perspectives from a variety of disciplines – including law, economics, politics, international relations and communication studies – to consider whether institutions form, evolve and change differently according to their historical or cultural environments and if their utilitarian functions can, and should, be observed, identified and measured in different ways.

The book discusses China's economic institutions, political and legal institutions, and the international institutions with which China engages; institutions promoting science and technology; institutions of local governance and media organization; and the household registration system. Through these case studies, it examines how institutions themselves have been formed, changed and re-formed over recent decades, and suggests theoretical and methodological adjustments in institutional analysis to allow a fuller understanding of the institutional dynamics of China's transformation.

Xiaoming Huang is Professor of International Relations at the Victoria University of Wellington, New Zealand. His recent publications include *The Rise and Fall of the East Asian Growth System, 1951–2000: Institutional Competitiveness and Rapid Economic Growth* (also published by Routledge).

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Contents

<i>List of illustrations</i>	vii
<i>Abbreviations</i>	ix
<i>Contributors</i>	xi
<i>Preface</i>	xv
1 Introduction: institutional analysis and China's transformation – issues and concepts	1
XIAOMING HUANG	
2 China and international institutions	25
HARRY HARDING	
3 Institution formation, imitation, and borrowing: Zhongguancun as a case study on mechanisms of institutional change	36
HONG SHENG	
4 Science and technology institutions and performance in China: the semiconductor industry	55
KEUN LEE AND RUI WANG	
5 Power, rights, and interests: a legal and economic analysis of urban housing demolition and relocation in China	78
YUJUN FENG	
6 China's road to <i>Rechtsstaat</i>: rule of law, constitutional democracy and institutional change	98
WEISEN LI	
7 China's evolving institutional exclusion: the <i>hukou</i> system and its transformation	110
FEI-LING WANG	

8	China's changing <i>hukou</i> system: institutional objectives, formal arrangements, and informal practices	130
	JASON YOUNG	
9	State capacity, democratic principles, and constitutional order: modern state-building in post-totalitarian society	152
	QIANG LI	
10	Institutional accumulation and gradual substitution: the dynamics of developmental democracy in China	161
	DINGPING GUO	
11	Propaganda vs. promotion: the political economy of CCTV	179
	YONG HE	
12	Village elections and the institutionalization of legitimate authority	197
	C. S. BRYAN HO	
	Appendix 1	
	Appendix 2	
13	Conclusion: the institutional dynamics of China's transformation – what have we learnt?	219
	XIAOMING HUANG	
	<i>Bibliography</i>	228
	<i>Index</i>	253

List of illustrations

Tables

1.1	Global competitiveness index: 1st pillar: institutions – China	9
3.1	Change in forms of transaction	51
4.1	The top 20 semiconductor suppliers in China	64
4.2	Semiconductor patents by country and by year	64
4.3	Assignees' country code of semiconductor patents with the first inventor being Chinese (1988–2006)	65
4.4	Both assignees' and the first inventor's nationality of the semiconductor patents is China (1988–2006)	66
4.5	Distribution of semiconductor-related patents in China (2001–2006)	67
4.6	Sources of knowledge in world's semiconductor patent by source country (%)	69
4.7	Sources of knowledge in China's semiconductor industry by source country (%)	70
4.8	International diffusion and sources of knowledge	71
4.9	Intra-national and inter-firm knowledge diffusion in Korea, Taiwan and China (%)	73
7.1	Institutional exclusion: a typology	113
8.1	Type of urban migrant as defined by <i>hukou</i> status	134
8.2	GDP growth in three strata of industries (RMB, 2008 rates)	137
8.3	Urbanization and MPS <i>hukou</i> type (2007)	140
8.4	Urbanization and MPS <i>hukou</i> type by region (2007)	142
8.5	Economic growth created by <i>nongmingong</i> in selected industries in Beijing (2003)	144
10.1	Levels of satisfaction with human rights in China	173
11.1	CCTV advertising revenue (1996–2002)	193
12.1	Participation rates in elections (November 1998 to May 1999)	208
12.2	Different ways of voting	208
12.3	The relationship between age and participation rate	209
12.4	The relationship between party membership and participation rate	210

12.5	Those who worked outside the village during the past 10 years and participation rate	210
12.6	Main reason for not participating in the last election	213
12.7	Logistic regression analysis of effects of independent variables on voting behavior	213

Figures

1.1	China's real gross domestic income per capita	6
1.2	Quality of institutions in China (1996–2007)	7
1.3	Quality of legal institutions in China (1980–2006)	8
3.1	The formation of Zhongguancun electronics street	42
3.2	Transaction cost in transitional economy	43
5.1	Proper (good) model	94
5.2	Abnormal (bad) model	94
8.1	Employed persons in rural and urban areas (1978–2007, %)	136
8.2	Employed persons by three strata of industry (1978–2007, millions)	136
8.3	GDP by three strata industries (1978–2007, %)	137
8.4	Per capita net income of rural and urban households (1978–2006, RMB)	138
8.5	Proportion of gross regional product per capita (1992–2007, %)	139
8.6	Non- <i>hukou</i> holders as a percentage of the regional population (2000, 2005)	139
8.7	Urbanization by non-agricultural <i>hukou</i> over 31 regions (2007)	140
8.8	National floating population (1980–2005, millions)	141
8.9	Beijing <i>hukou</i> and non- <i>hukou</i> population (1978–2007, millions)	143
8.10	Natural and non-natural real change in the Beijing <i>hukou</i> population (2003–2007)	144
8.11	Comparison of non-local and <i>hukou</i> employment type in Beijing (% , 2000, 2005)	145
8.12	Average time at destination of Beijing non- <i>hukou</i> residents	145
8.13	<i>Hukou</i> and non- <i>hukou</i> population in Shenzhen (1979–2006)	146
10.1	Public attitudes to political systems in China (%)	172
10.2	Comparing public opinions on democracy (%)	173
11.1	The internal and external dual leadership system for CCTV	181
11.2	Forces shaping broadcasting institutions in China	187
11.3	CCTV advertising bids (2002–2009)	190
11.4	Change in political communication content in <i>Xinwen lianbo</i> (%)	190
11.5	Procedures and process for news inspection and approval at CCTV	191

Abbreviations

ABD	Asian Development Bank
AGOV	gross output value of agriculture
APEC	Asia-Pacific Economic Cooperation forum
ARATS	Association for Relations Across the Taiwan Straits
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
ASEAN+3	ASEAN plus China, Japan and Korea
ASMC	Advanced Semiconductor Manufacturing Corporation
AVCER	Anhui Villagers' Committee Election Regulations
CBA	Central Broadcasting Administration (<i>Zhongyang guangbo shiyebu</i>)
CCCPC	Central Committee of the Communist Party of China
CCTV	China Central Television
CDPC	Central Department of Political Communication (<i>Zhongxuanbu</i>)
CMEA	Council for Mutual Economic Assistance
COEs	collectively owned enterprises
COMECON	Council for Mutual Economic Assistance
CPC	Communist Party of China
CPIC	China Patent Information Center
CPPCC	Chinese People's Political Consultative Conference
CSIA	Chinese Semiconductor Industry Association
DCF	Democratic Consultative Forum
EAS	East Asian Summit
EFI	Economic Freedom Network
EMS	electronics manufacturing services
FDI	foreign direct investment
GATT	General Agreement on Tariffs and Trade
GCI	Global Competitiveness Index
GDP	gross domestic product
ICT	Information and Communication Technology
IDMs	integrated device manufacturers
IGOV	gross output value of industry per capita
IMF	International Monetary Fund

MNCs	Multi-national corporations
MPS	Ministry of Public Security
NGOs	Non-governmental organizations
NPC	National People's Congress
OECD	Organization of Economic Cooperation and Development
PCI	per capita income
PRER	Pearl River Economic Radio
PSB	Public Service Broadcasting
R&D	research and development
RMB	<i>renminbi</i>
S&T	science and technology
SARFT	State Administration of Radio, Film, and Television (<i>Guojia guangbo dianying dianshibu</i>)
SATS	semiconductor assembly and test services
SCI	Science Citation Index
SCO	Shanghai Cooperation Organization
SIPO	State Intellectual Property Office
SOEs	state-owned enterprises
STAQ	Securities Trading Automated Quotations System
UREs	University-run Enterprises
USPTO	United States Patent and Trademark Office
WGI	Worldwide Governance Indicators
WIPO	World Intellectual Property Organization
WTO	World Trade Organization
ZMC	Zhongguancun Management Committee
ZSTZ	Zhongguancun Science and Technology Zone

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Preface

Institutions are the embodiment of the social constraints that societies choose to enforce, and they provide the framework within which social and economic interactions occur. They are of interest to scholars because of the insight that they can provide into the interrelationships between economic, legal systems, social and political systems of individual economies. Institutions are of particular interest to economists because they determine the way in which competition for scarce resources is managed, whether through private markets, communal ownership or state allocation, through freedom to reallocate labor and capital resources to locations and activities where the market dictates their highest value or through state planning and control, and through the free exchange of information or the control of information by the state.

Scholars in the social sciences, economics and law interested in explaining the heterogeneous paths to economic development that have been followed by different countries have explored numerous dimensions of institutional analysis. But institutions became much more interesting in the past two decades as Western academics began to pay attention to the extraordinary level of social change and economic development occurring in Asia within the framework institutional structures that are quite different to those prevailing in the West. This represented a challenge, not just to the earlier presumption of the superiority of Western political, social and economic institutions as a basis for economic development, but also to our understanding of how institutions matter and which institutions matter the most.

One explanation for advances that have been achieved in China despite the differences between its institutional structures and those in the West is that Chinese institutions represent “second best” efficient outcomes – that is, that they represent efficient responses to the constraints provided by Chinese political and social systems. But this explanation is inherently unsatisfying for both its presumption that the institutions resulting from Western political and social systems represent the efficient, or transaction cost minimizing framework for economic advancement, and for the cursory interest that it demonstrates in the complexity of the interaction between social traditions, the political system, and institutions in modern China.

The essays in this book represent an important addition to the growing literature on Chinese political, social and economic institutions and their significance

for the transformation that has occurred in China in the past 30 years. They provide important lessons not just about particular institutions in China, but also about the complexity of the interactions between institutions in that society and the economic transformation that has occurred. They demonstrate that there has been substantial evolution in key institutions in China during the period of economic transformation, but that to understand this evolution it is necessary to understand the social and political context within which they emerged, and the dynamic interaction between legitimacy, capacity and effectiveness in determining the direction of institutional change. In this sense the essays in this book also represent a substantial and important contribution to the wider international literature on institutions and economic development.

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1 Introduction

Institutional analysis and China's transformation: Issues and concepts

Xiaoming Huang

Over the past thirty years since the launch of economic reform and opening, China has seen fundamental economic transformation, and social and political change. The grand scale and contested nature of the transformation have generated great scholarly interest. Of particular scholarly value is the growing interest in the role of institutions in the shaping of the emergent China.

Today, few scholars would dispute that institutions matter. The question is perhaps how exactly they matter in particular national and historical settings. Institutional analysis is increasingly facing challenges from diverse national experiences and institutional environments. Moreover, there are a large number of studies on China's transformation, but not many from a unifying intellectual approach involving a multi-disciplinary investigation. There is also a great deal of scholarly interest and research activities in China itself on institutions and Chinese political economy, but this has not received the wider scholarly attention it deserves.

The chapters in this volume are intended to address these issues. This introduction will first explain the core research problem that requires scholarship of both China studies and institutional analysis and provides the rationale for this project. It will then offer a critical review of key approaches to institutional analysis and suggest that the dominant state-centric approaches are inadequate for explaining China's 30-year transformation, and that more pluralist approaches are needed. Pluralist approaches look at institutions as embodying a broader set of rules and arrangements, the formation and change of which are not primarily driven by the state. The last part will summarize findings from the chapters and their contributions to a better understanding of the theoretical and methodological problems in institutional analysis of large-scale national economic and social change.

The China puzzle

Ever since the successful industrialization and modernization of West Europe and North America, theories and predictions about the conditions and probability of similar experiences taking place in the rest of the world have formed a huge field of scholarship. At one point, socialist states appeared to be able to produce

comparable stories of industrialization and modernization, though organized on very different foundations and premises. In the 1950s and 1960s, the intensive race between the United States-led western world and the Soviet Union-led communist world focused squarely on whether socialism or capitalism can better deliver industrialization and modernization. This race however soon came to a conclusion.

The “Asian miracle” (World Bank 1993) economies from the 1950s to the 1990s produced waves of successful stories of rapid economic growth, industrialization, and economic and social development. While the precise nature of these economies and their models of growth and development are a matter of scholarly debate,¹ these Asian miracle economies were associated or allied mostly with the United States and the West alliance. There is good reason to argue that their successes exemplified the same logic that drove the “rise of the Western world” (North and Thomas 1973). On the other side of the race, the economic system of the socialist states finally crumbled along with the collapse of the political empire of the Soviet Union towards the end of the 1980s.

When China started its opening and reform in the late 1970s and early 1980s, therefore, there was an undisputed alternative to Mao’s failed utopian socialism. While the general public in China may not have had much understanding of what it was that made life good in the West, and even in the “four little dragons” (Vogel 1991), the intellectual elites were at the forefront advocating fundamental changes to the political system, constitutional order, social structure, cultural traditions, and of course the economic model and its associated institutions. Indeed, this was part of a long historical battle, since the beginning of China’s more substantive encounters with the Europeans in the mid nineteenth century, a battle between those who believed in the enduring power and merit of the Chinese system and those who argued that only by adapting more advanced European, or “modern,” systems could China become strong and prosperous again. The Chinese had been searching for a way to be a “rich country with a strong army.” Initially, the *Yangwu Movement* in the latter part of the nineteenth century was aimed at reinvigorating industry and the army by adopting advanced technology, and models of modern industry and factories, used in Western countries. This movement failed with the defeat of the North Ocean Fleet, a core project of the *Yangwu Movement*, in the first Sino-Japanese war of 1894–1895.

The failure of industrial salvation led to attempts to look for political solutions. The *Hundred-Day Reformation*, in 1898, spearheaded by reformed-minded political and intellectual elites, including the young emperor himself, marked a high point of such efforts. The *Hundred-Day Reformation* aimed at reforming the monarchic system, as well government, economic and military institutions, and was modeled very much after the *Meiji Restoration* of 1868 in Japan. The *Hundred-Days Reformation*, however, impinged directly upon the cores of the existing system, and the people and their interests behind it, and led to a strong reaction from those high up in the imperial hierarchy. It ended with the execution of the reform advocates, mostly political and intellectual elites, and the consolidation of the political power of the conservative forces.

With the failure in both industrial salvation and political reform, efforts to change China shifted to addressing the cultural roots of China's problems. The *New Cultural Movement* in the early twentieth century, led by prominent intellectual elites, particularly those educated in the West or influenced by Western thoughts and ideas, took on Confucianism along with the Chinese traditional writing script, social rituals, religion, education system, social structure, way of life, etc. as what had made China weak, declining, and deteriorating. This was against the backdrop of the growing presence of strong and modern European powers in the region, and the remarkable achievement of reform and modernization in Japan. "Science" and "democracy," or "Mr. S." and "Mr. D.," were seen by their advocates as the two principal values for a new China.

It is here we see the early signs of institutional idealism in modern China. The *New Cultural Movement* reached its zenith at the *May Fourth Movement* in 1919 where the advocates split into a more radical faction, which became the basis of the Communist movement in China, and a more moderate faction, which provided much of the intellectual support for modern liberalism in China. The radical faction formed the Communist Party of China (CPC) in 1921. Boosted by the *October Revolution* in Russia in 1917, the Communist elites in China came to firmly believe that institutional revolution, rather than institutional reform, was not only desirable as a solution to the "China problem,"² but also historically possible.

The Chinese Communists won the battle against the more moderate Nationalists in the following 30 years of civil conflicts and war, and successfully organized a large-scale, rural, peasant-based revolution and overthrew the established system. Once in power, Mao pushed forward his Communist ideal into reality in a step-by-step radicalization of his program for a comprehensive and revolutionary reorganization of Chinese society. The Mao-style "shock therapy" took little consideration of the interests of any individual, or any groups; gave no respect to existing institutions and social traditions; and proceeded with an expectation that the reorganization of Chinese society could be accomplished in a decade or two and that China would catch up with Great Britain and the United States within 20 years with its all-new, superior socialist institutions in place.

When Mao died in 1976, the problems with his comprehensive socialist revolution were clear to everyone. Within China itself, however, interests associated with Mao's socialist system were naturally very strong after being built up for 30 years. Political battles were yet to come over Mao's legacies, particularly his theory and practice of socialism, and the consequent institutions embodying his model. While different political interests and forces were far apart from one another over what should come next for China, there was ironically a significant level of consensus among key interest groups, political forces, and intellectual elites in the belief that a better set of institutions would save China from political chaos and move China toward modernization. The only question was which set of institutions. There was not much of a choice, after all: either stick to Mao's ideas and the system he had put in place, or else China would need another revolution to institute freedom and democracy, and a more efficient and productive

economic system. While Maoism may have died, the belief in the power of institutional models to change society continued to shine – bringing the tradition of institutional idealism to a new stage.

Institutional idealism was not confined to China. The early years of China's 30-year transformation were a time when political conservatives in the United States and the Great Britain were looking for liberal economic policy to re-energize their economy. Reaganomics and Thatcherism in the 1980s laid the seeds of the global movement of neo-liberalism in the 1990s. The ideology of small government and free market, the political pressure of the global neoliberal movement to restructure, reform, and, indeed, to reorganize society were no more strongly felt than in China.

Today when we look back, 30 years on, the national campaign to transform China into a rich, strong, and prosperous country seems to have achieved its mid-term targets. But this transformation has apparently followed no clear definable model. It is hard to label today's China in any ideological terms. Indeed, it is perhaps more appropriate to state that China has transformed rather than that China has been transformed. The China experience is particularly interesting to institutional theorists and analysts. The role of institutions in large-scale national economic and social transformations has been a key subject of debate for social scientists. Karl Polanyi's work on the rise and fall of the political and economic order in the "North Atlantic Community" of the nineteenth century (Polanyi 1944), Douglass North and Robert Thomas' work on the rise of the "Western world" (North and Thomas 1973), and Mancur Olson's theory on the rise and fall of "nations" (Olson 1982) have set the general parameters for later research. Institutional explanations of national transformation have focused on the decisive effects of institutional frameworks on national growth and development. The causes of economic growth are said to be found in efficient economic organization.

At the heart of institutionalist theories is the problem of efficiency. According to such theories, desirable social and collective outcomes, such as national development, would not naturally arise from individuals' preferences and activities. Institutional arrangements are therefore needed to "create an incentive to channel individual economic effort into activities" that would bring social and collective benefits (North and Thomas 1973: 1). This parity between private and public benefits is what institutionalists call efficiency, or more precisely, institutional efficiency.

The economic and social transformation of China provides an ideal opportunity to test some of the key claims of the institutionalist theories. Indeed, recent studies on China have documented the challenges that these theories face in explaining the role of institutions in China's transformation (Brandt and Rawski 2008; Chen, Jefferson, and Singh 1992; Woo 1999; Rawski 1999; Naughton 1996; Rozelle 1996; Lin *et al.* 2003; Lin 1989; Fan 1996; Sheng 1994): (1) China's transformation started when there was almost no separation between the public/social and the private/individual. In particular, there was initially no private property and no private ownership; and (2) China's rapid growth and development took place when those institutions considered to be efficiency-prone in conventional theories were weak,

ineffective or did not exist. The parity premise of the institutionalist theories therefore seems to be problematic in the case of China. If institutions have been weak and inefficient, did they matter in China's transformation? If the answer is yes, then in what ways did they matter? How have economic efficiency and growth been achieved in China with "flawed institutions"? (Brandt and Rawski 2008) Sustained economic growth and social development under problematic institutions seems to be a puzzle.

Before we attempt to explore these questions further, let me first describe the China puzzle in more empirical terms so as to verify the basic premises of the claim. The China puzzle can be broken into two propositions: (a) institutional efficiency has been achieved in the 30-year transformation, and (b) institutions in China were and are still ineffective and inefficient. We will take the first proposition first.

Efficiency, growth, and growth outcomes

In the preceding section, I laid out the basic argument of why modern national transformation can be first and foremost understood as the gaining of institutional efficiency. I also traced back to the roots of New Institutional Economics for the core concept of efficiency. Efficiency, as defined by New Institutional Economics, is the parity gained between private and social rates of return. This is different from how the concept of efficiency is used by, for example, growth economists. For the latter, efficiency is essentially productivity, i.e. output per unit input. With optimal provision in factors of production, such as capital, labor, land, and increasingly technology, one can expect a more productive economy. These, in the words of Douglass North and Robert Thomas, are "not the causes of growth, but they are growth" (North and Thomas 1973: 2).

What interests institutionalists is not growth activities themselves, but rather why members of society are more, or less, willing to engage in economic activities. Institutional efficiency therefore is the quality of economic and social organization that makes individuals and groups willing to participate in economic activities. Economic growth essentially is the increase in the volume of economic activities at the aggregate level. As efficiency so defined implies an equal satisfaction of the interests of both society and individuals in their economic activities, economic growth can be defined and measured by change in the rates of return for all members in society. It is in this logic that North and Thomas use "a per capita long-run rise in income" to measure economic efficiency. "True economic growth," according to them, "implies that the total income of society must increase more rapidly than population" (North and Thomas 1973: 1).

It is this long-run rise of per capita income that I use here to measure efficiency gains. There has been a substantial and sustained rise in per capita income over the past 30 years in China, since the late 1970s. As a point of reference, there was relatively little movement in per capita income in the first 30 years of the People's Republic of China from 1949–1979. From the data presented in Figure 1.1, we can conclude that there has been a significant "long run rise" in per

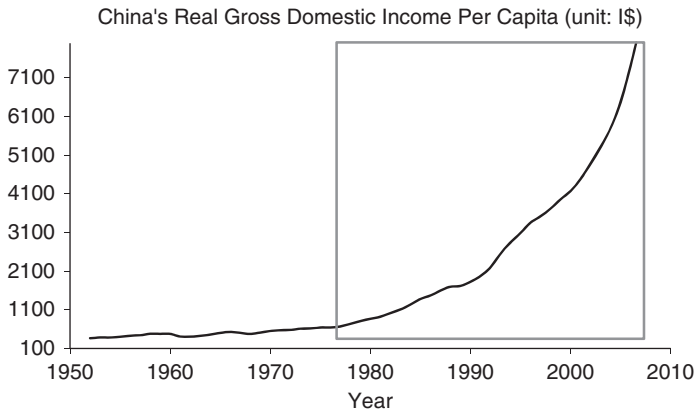


Figure 1.1 China's real gross domestic income per capita.

Source: Heston, Summers and Aten, 2009.

capita income in China. Institutional efficiency must have been achieved for such a rise to be possible.

Quality of the institutions

There have been great efforts in the development of measurements of the quality of institutions in relation to modern economic development and to governance in general (Keefer and Knack 1995 and 1997; Burki and Perry 1998; Campos 2000; Kaufmann, Kraay, and Mastruzzi 2008). These efforts range from those very preliminary and indicative uses of the concept in early studies, including Karl Polanyi's (1957) four institutions behind nineteenth-century European civilization, Paul Kennedy's (1987) three institutional pillars supporting the European miracle, and North's focus on property rights, to more recent attempts at a more systematic and scientific measurement of the quality of institutions. Notable among the latter are the World Bank's Worldwide Governance Indicators (WGI), Economic Freedom of the World (EFI Index) by the Economic Freedom Network (2009), and the Global Competitiveness Index (GCI) by the *World Economic Forum*.

The WGI (World Bank Institute 2008) is the most comprehensive measurement of the quality of institutions over a considerably long period of time. The WGI data covers the period from 1996 to 2007. It does not give us a measurement of the quality of institutions in the early years of China's 30-year transformation. But given the nature of our inquiry, indicators from the mid-1990s should provide sufficient evidence of the quality of China's institutions for the 30-year period with which we are concerned, as we assume the quality in the earlier years can only have been worse. The six sets of aggregate indicators, "drawn from 35 separate data sources constructed by 32 different survey institutes, think tanks, non-governmental organizations, and international organizations," measure six dimensions

of the quality of governance, defined as the institutions and processes by which “governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them” (World Bank Institute 2008).

The EFI (Gwartney and Lawson 2008) is part of the WGI, but it is used here on its own for two reasons. First, its data starts from 1970 which gives a better measurement of the historical change of the quality of institutions. Second, the index, particularly its Area II indicators – *Legal Structure and Security of Property Rights* – measures the “extent to which rightly acquired property is protected and individuals are engaged in voluntary transactions” (Economic Freedom Network 2008). Given the central thrust of North’s argument on the rise of the West, this indicator is significant.

The GCI measures competitiveness in a set of “institutions, policies, and factors that determine the level of productivity of a country.”³ A key component of the “12 pillar” index, which is used here, measures institutions broadly defined as both legal and government institutions in the public sector as well as private sector institutions.

Figure 1.2 presents the WGI data on China as an indication of the quality of institutions in China over the 10-year period from the mid-1990s to mid 2000s. Of the six general categories of indicators, the indicators on voice and accountability are, unsurprisingly, very low, moving around the average of -1.53 on the scale of 2.5 to -2.5 , with 2.5 being the highest quality. The best category is

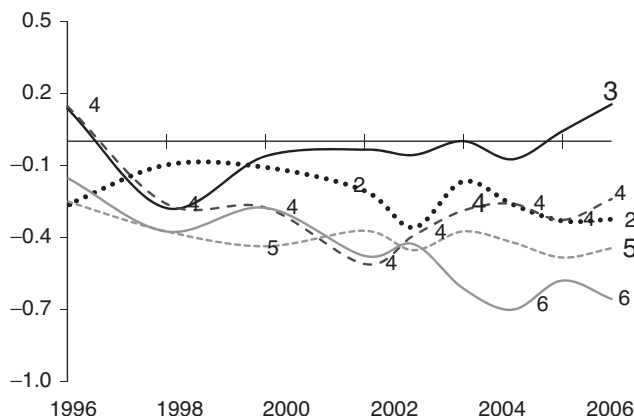


Figure 1.2 Quality of institutions in China (1996–2007).

Source: Kaufmann, Kraay and Mastruzzi, 2008.

Note: Scale: -2.5 lowest to 2.5 highest quality 1. voice and accountability 2. political stability 3. government effectiveness 4. regulatory quality 5. rule of law 6. control of corruption.

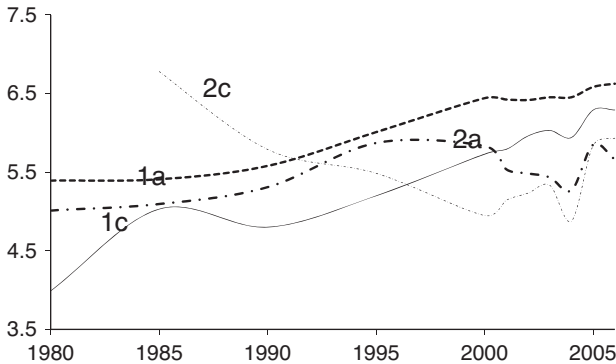


Figure 1.3 Quality of legal institutions in China (1980–2006).

Source: Gwartney and Lawson 2008.

Note: Full scale: 0 lowest to 10 highest quality (c) China (a) World average 1. Summary index 2. Legal structure.

“government effectiveness.” Even this was around the neutral bar with an average of -0.02 over the ten years. Indicators in all the other categories were below the neutral level.

The EFI data is plotted on Figure 1.3. The two data lines are the overall measure of all five EFI areas (1) and the index on Area II: legal structure and security of property rights (2). China’s indicators (c) are compared with the world average (a). In terms of the overall measurement, China (5.55) is constantly around 1 point lower than the world average (6.16) on the scale of 0 to 10. For indicators on legal structure and security of property rights, China started higher but moved below the world average and then the two converged towards the end. Do note that the comparison here is with the world average rather than the usual benchmark of countries in more advanced stages of development. In other words, the quality of China’s institutions has been lower than the world average for the past 30 years and far below countries in more advanced stages of development. The data on the legal structure raises more questions than it answers. It is hard to argue that legal structure and the security of property rights in China were much better in the 1980s than in the 1990s, because, for one thing, there was no private property ownership in earlier times. It is also hard to argue that the situation regarding legal structure and the security of property rights was getting worse in the 1990s. But one conclusion from the data is clear: that the quality of China’s institutions of legal structure and property rights was lower than the world average for much of the period.

Finally, Table 1.1, with data from the *Global Competitiveness Report 2008/9* (Schwab and Porter, 2008), provides another measurement of the quality of institutions. In 2008, most of the institutions deemed necessary for economic growth were considered in the report to be a “disadvantage” in the case of China, i.e. non-competitive, insufficient, or low quality. Of the 18 sets of institutions, from property rights to judicial independence, only one, the burden of government regulation,

Table 1.1 Global competitiveness index: 1st pillar: institutions – China

<i>Indicator</i>		<i>Rank (Total 134)</i>	○ <i>Disadvantage</i> ● <i>Advantage</i>
1	Property rights	54	○
2	Intellectual property protection	53	○
3	Diversion of public funds	66	○
4	Public trust of politicians	36	○
5	Judicial independence	69	○
6	Favoritism in decisions of government officials	47	○
7	Wastefulness of government spending	36	○
8	Burden of government regulation	23	●
9	Efficiency of legal framework	54	○
10	Transparency of government policymaking	46	○
11	Business costs of terrorism	89	○
12	Business costs of crime and violence	56	○
13	Organized crime	84	○
14	Reliability of police service	50	○
15	Ethical behavior of firms	60	
16	Strength of auditing and reporting standards	86	○
17	Efficacy of corporate boards	90	○
18	Protection of minority shareholders' interests	94	○

Source: Adapted from Klaus Schwab and Michael E. Porter, 2008.

was considered favorable for China. China typically stands lower than average in ranking on these individual indicators.

We can draw several conclusions from the above evidence. First, the quality of the institutions in China, those considered necessary for economic growth in conventional institutional theories, has been below the world average. The WGI gives more consistent evidence of this for the period from the mid 1990s. The EFI evidence runs from 1980 onwards. The GCI (Schwab and Porter, 2008) confirmed this in 2008/2009. Second, evidence varies as to whether the quality of institutions has improved over the years. The WGI suggests that the quality has been quite steady while the EFI's data at two different levels give conflicting evidence.

Overall, the evidence here provides empirical support for the premise of the China puzzle: institutional efficiency has been achieved while the provision of institutions for economic growth has been insufficient and the quality of institutions is generally low. While we assume that the quality of institutions has improved over the period, along with the progress in reform and development, we do not have enough data to explain how the quality level has moved over the 30-year period.

Institutional analysis and economic growth

The findings which I have detailed have been challenged on several counts. First, some people have disputed the fact that efficiency and economic growth have

been achieved in China. This challenge, however, has largely been dealt with empirically as time has gone by.

Much of the interest in an institutional explanation has focused on the part that institutions have played. First, there is a question of validity: whether the indicators of institutions used here are the institutions which institutionalists claimed were necessary for efficiency and economic growth. Second, there is a question of national institutional setting: whether the notion of institutions is relevant to China. To answer both questions, we need to revisit some of the basics of New Institutional Economics that have led to the development of a field of institutional theory explaining the relationship between institutions, on the one hand, and economic growth and social development on the other. I shall demonstrate that New Institutional Economics is essentially state-centric. Because of its dominance in institutional analysis, the mainstream approaches are both influential and insufficient at the same time in explaining large-scale economic and social changes in different national and cultural settings. Studies built on the basic logic of NIE are increasingly looking to go beyond the general belief that the state, through the institutions it provides, imposes, and enforces, is the cause and naturally the solution to the problems in efficient economic organization.

The tradition of state-centric institutional analysis

That NIE is essentially state-centric seems to be quite a significant claim. Considering that NIE is regarded as being informed primarily by neoclassical economics, such a claim requires elaboration. New institutionalism is new in its contrast to old institutionalism.⁴ Old institutionalism focuses on “state” institutions, public sector organizations, and examines how they affect the organization of economy, society, and politics. John Commons, in the early twentieth century, for example, argued that state institutions are essential for the function of economy (Commons 1934) and devoted much of his professional career participating in government legislation as a way of shaping and influencing economy and society. Max Weber, about the same time as Commons and also with a sociology background, focused on state bureaucracy as a core dimension of the rise of the modern state and economy. The old institutionalism came form the intellectual basis of the post-World War II campaign for development and modernization in the developing world. “Getting the institutions right”, i.e. having free elections, multi-party competition, functioning governments, or a modern state in general, is considered to be a prerequisite for economic growth, social development, and modern transformation. The institutions, here, are political, economic, and legal ones.

For New institutionalists, many of the institutions in Old institutionalism are what they would call “organizations.” Both in terms of economics and political science, New institutionalists are interested in the “rules of the game,” rather than the “players of the game” (North 1993). In economics, Ronald Coase, a founding figure of NIE, demonstrated to us how and under what conditions the allocation of property rights matters in economic efficiency. Douglass C. North explained why institutions such as property rights are necessary for the market economy to work.

While NIE indeed uses different matters to explain economic efficiency, what it retains from Old institutionalism is an ultimate reliance on the state as an explanation as well as a solution to the problem of efficiency in economic organization. This can be seen at two different levels. First, as a framework, NIE, argued North, is less concerned with the operation of the market, and much less concerned with how the market determines economic efficiency, than is neo-classical economics. NIE is about how markets develop and about policies that “will induce development” of the market (North 1993).

Second, at the conceptual level, North has a well-cited definition of institutions: “Institutions are the humanly devised constraints that structure human interaction. They are made up of formal constraints (rules, laws, constitutions), informal constraints (norms of behavior, conventions, and self imposed codes of conduct), and their enforcement characteristics.” Here, there has never been a clear definition of “formal.” For North, the difference between formal and informal institutions is just a matter of degree (North 1990: 46). But in its actual use, there are two possible interpretations of *formal*. A narrow definition would equate formal with *legal*, which is essentially “of the state.” In a broader interpretation, a “formal” institution is one over which there is a high concentration of control (Redmond 2005: 665–6),⁵ and rules and procedures that are “*official*” (Helmke and Levitsky 2004: 727). Formal institutions therefore can include “state institutions (courts, legislatures, bureaucracies) and state-enforced rules (constitutions, laws, regulations), but also what Robert C. Ellickson calls “organization rules,” or the official rules that govern organizations such as corporations, political parties, and interest groups” (Helmke and Levitsky 2004: 727, Ellickson 1991: 31). A chapter, bylaw, or individual contract may occur between or among individuals or groups. But the *control of the institution* lies in the state as it should be in the very original spirit of NIE. Indeed, much of the formal institutions discussed in NIE literature are state laws and their extensions. It is no surprise that NIE always looks to the polity and its policies as the foundation of economic performance.

The state-centric nature of NIE can also be seen in North’s definition of informal institutions. In his Nobel Prize speech in 1993, North spent one third of his time discussing another concept: beliefs. In his view, beliefs play an important role in shaping economic performance in an inefficient economic or political market and it is exceptional to find an efficient economic or political market (North 1993). It is not always clear in North’s writings how beliefs relate to institutions. Are they part of institutions, alternative to institutions, additional to institutions? In North’s Prize speech, beliefs are the culture of a society and an individual’s mental model, and are additional to formal and informal institutions. Given that institutions are “humanly devised constraints,” beliefs cannot be institutions. In his 1990 work, however, informal institutions “are part of the heritage that we call culture” (North 1990: 37). If both informal institutions and beliefs were part of culture, “informal institutions” so defined are logically not part of institutions. Given the fact that the empirical work of North and other NIE pioneers mainly focused on the role of formal institutions, the core of the definition and its state-centric focus is evident.