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# China's Market Economy—A Historical Perspective

*Francis S.L. Wang\** and *Laura W. Young\*\**

## I. INTRODUCTION

Economist Hernando De Soto has described the necessary ingredients for a market economy, and stated that a key ingredient is trust. De Soto provided statistics from a study that indicate that fifty percent of Americans trust each other. The same is true of Scandinavians. Apparently that is a proportion sufficient to support an effective market economy. However, only about ten percent of the people from his native Peru trust each other, and only about five percent of Brazilians trust each other. We do not know what the level of trust is in Argentina today, but estimate that it is probably very low.

But what is trust? Trust is confidence in a relationship with someone else and with the overall economy. Trust is believing that when you make an economic bargain, the bargain will be fulfilled, and if it is not fulfilled, a mechanism exists that allows for some form of redress.

We will first look at the economic and legal changes in China. To begin this discussion, it is important to address the level at which most people really participate in their economy. Clearly, most people receive wages and buy food and clothing. But that seems insignificant to the overall economy. In terms of significant capital, such as equity investments, the majority of people do not actively participate. Most do not own or trade stocks or bonds. However, people can participate in an economy in a significant sense by purchasing a home.

## II. TRADITION OF PROPERTY OWNERSHIP

What is the tradition of property law in China and why are these issues important? To broadly and inaccurately summarize Chinese history, in almost every dynasty reaching at least to the Tang Dynasty—that is around 600 A.D.—there was a tradition of property ownership reform. This tradition was part of the cyclic rise and fall of dynasties. The fall of a dynasty was usually accompanied by war, famine, drought, rebellion, and death. Then a new dynasty would take control, redistributing the arable land to the populace it wished to encourage, and confiscating land from undesirable populations. An example is the Tang Dynasty's Balanced Farm Law, which encouraged re-population of certain areas

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by granting one hundred mu to every male over the age of fifteen. That was roughly equal to a grant of twenty acres. Disabled persons and women also received land for their subsistence. Widows, as female heads of household, received one-third of a man's share. The new owners were listed on the new dynasty's tax rolls, and there was a land ownership system at that time equivalent to a county recorder, with recorded deeds. Written deeds were a legal requirement to prove land ownership, a concept certainly understood in the West as well.

The Communist polemic claims that China was a feudal society before 1949. This is incorrect as there were no serfs tied to the land and family land ownership goes back thousands of years, including ownership of the means of production (farm land), and ownership of a residence. This was private property ownership with a very sophisticated set of rules, laws, and regulations. There were tangible and intangible rights to real property, which became extremely important when China began to modernize in the twentieth century. This traditional system was called different names in different regions of China, and included customary property rights. One such name is the Land Skin and Land Bone system. For example, imagine that one family (referred to as the Wang family) owned a large farm for generations, which included a rocky hill. The hill was not used for anything except family tombs. Then imagine that another family (referred to as the Young family) in the area, decided that it needed more land because its family had outgrown its own land holdings. It was possible for the Young family to make an arrangement with the Wang family so that the Young family could cultivate the unused portion of the Wang family land in exchange for some rights in the land. The Young family would usually have paid the Wang family a portion of the proceeds from cultivation. The Wang family would have owned the "land bone," which is essentially the residual interest in the land, and the Young family would have owned the right to cultivate the land, which would be the "land skin." The Young family could sell the "land skin," rent it, mortgage it, and pass it to their children.

When China began to modernize in the late Ch'ing Dynasty (about 1880-90), it looked at a variety of Western legal structures. By the time of the new Republican government in 1911, there was a very active movement to reform China's legal system. By 1928, Chiang Kai-shek's Republican government finally gained complete control of China and a vast legislative reform movement began. From 1927 to 1930, a flood of new laws were passed, some of which remain in force on Taiwan to this day.

In the previous thirty years, many scholars had criticized China's system of customary laws as an impediment to its economic and military development. Scholars advocated following a German model of law, particularly as the Japanese had already done so, and it was an easy step to translate works from Japanese to Chinese. At the time, China's laws were patterned after the German system of civil law and codes, and they still are today. China was convinced that the unitary concept of property ownership was the best system to further

economic development. China incorporated the ideas wholesale, rejecting what was already developed and what resonated well within its society, and decided to graft on to something new.

German scholars propounded the necessity of a unified theory of property ownership. Chinese scholars believed that the unified theory was a factor in Europe's economic success, thus, it was determined that China needed to follow the European model.<sup>1</sup> Accordingly, in 1937 the Judicial Yuan announced that land skin ownership was akin to rental. The decision disenfranchised a large working population since the laborers on the land no longer had an ownership interest in the land.<sup>2</sup>

Of course, Communism was another graft from the West. One of the benefits of studying twentieth century China is the ability to see a tremendous social experiment on the largest scale in history. When has so much ever been done so quickly to so many people, and then suddenly reversed? In a sense, the second half of the twentieth century looks like another cycle in the tradition of dynastic change. It was large land re-distribution all over again, but into collectives, and communes. These, as everyone knows, were a general failure.

What do you get by the 1980s as a result of these various changes in trying to eradicate capitalism? On a typical street in Shanghai, the main buildings were remnants of the evil pre-revolutionary period. The tallest buildings were built in the 1920s, but still used in the 1980s. These office buildings built in the 1930s, with elevators that stopped working twenty to thirty years before, were still used though no one bothered to maintain them. The lighting systems had stopped working. In some cases, people strung light bulbs up the staircases to make the buildings functional. Everything was broken down, and there were no alternatives. Very little new construction took place and there were few incentives to do anything about it. No one took care of the filth, and no one was going to take care of the streets.

Bicycles were horrible and ugly. No one wanted to own a pretty bicycle because it would get stolen. Instead, a person wanted to have the ugliest, rustiest, most beat up bicycle in the world because it would still be there when he or she wanted to use it.

China has always been a country with many rules, even during the collective era. In fact, the minimum amount of living space per person was allocated by regulation. Part of the Communist and Socialist system is a belief in basic human rights, including positive rights like entitlement to shelter. This begs the question of what constitutes shelter. The Communist regime looked at the amount of shelter available, and decided how much shelter each individual could be given. If you spread your arms out to your sides, you will see roughly the amount of space a person living in Shanghai was supposed to have in the 1970s and early

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1. HUANG, PHILLIP C.C., *CODE, CUSTOM, AND LEGAL PRACTICE IN CHINA: THE QING AND THE REPUBLIC COMPARED* (Stanford University Press 2001).

2. ROC JUDICIAL YUAN, 1937 ANNOUNCEMENT NUMBER 1703, 3 JUDICIAL YUAN COLLECTION, 1453.

1980s. There was no market in property at that time, and no one had incentive to maintain, let alone, improve or build new, homes.

The records to show who had possession of the property were always clear, but without the right to transfer those property, there was no incentive for property improvement. The state owned all the homes, and everything else. Individuals did not have the right to say "I hate this place; I need to find some place else that is more comfortable." There was no remedy for those unhappy with their living arrangements. In the early 1980s, a typical one-family house built in the 1920s was then required to accommodate four families. You could have twenty people in a two-bedroom house. As long as the minimal amount of space required was present, there was no point in complaining because there was no possibility of improvement.

### III. RE-EMERGENCE OF PROPERTY OWNERSHIP IN MODERN CHINA

What is modern China like? Agricultural land was privatized first, followed by urban housing. In fact, the privatization of agricultural land worked fairly well, which is why the State privatized urban home ownership as well. Real estate decorating brochures can now be found around China's cities, which epitomizes the current state of affairs in China. The brochures show modern designs, but with traditional Chinese characteristics. For example, one brochure showed rooms with zig-zag mullioned windows and moon gate style doors. Sometimes we make fun of it, but they reflect an important development: these are private changes rather than government imposed.

How did the Chinese government create a market for private property? Sara Carey of Yukos earlier referred to the Russian model. She noted that Russians were sometimes just given the homes that they lived in. China was quite a bit different. People in China usually were granted by their work-unit the opportunity to purchase the home they were living in. Generally, the price was around two thousand to three thousand U.S. dollars for a 350 sq. ft. apartment. Workers were allowed to buy the home, which meant that they had to pull capital together from relatives and friends. Some worker units gave the property to the residents, but by and large, work-units wanted to be paid something for the assets they were relinquishing. Sometimes those people that did not want to purchase a home were allowed to receive a payment of money instead. For example, if a husband and wife worked for different work-units, and both had an opportunity to get a home, they could receive one home and one payment. They could then use the money they received as capital to fix up their home, or to loan to relatives to help them buy a home, etc.

With the right to buy land, people finally had something to invest in. As a result, a huge real estate market developed, as well as, a secondary market for home design and resale. The number of *Better Homes and Gardens* and *Architectural Digest* type magazines grew tremendously. Another phenomenon

that occurred was the emergence of real estate agents. An entire active industry took root, supported by additional subsidiary industries.

As a result of these recent reforms, China's urban population is generally speaking content. However, China has a huge problem because its growth is not balanced. Out in the countryside, it still looks like it did eighty years ago. Regardless, at least there is progress and rural populations hope to participate by moving to the cities. Modernization has begun and has taken a foothold in the urban centers of the country. New jobs, savings, and all the wonderful things that accompany modernization, show a lot of promise for further development.

The modern process began with gradual steps. The current transition in China was not done by the shock method. The work-units did not sell all at once and the people in China did not get their homes all at one time. This all occurred gradually over a number of years.

Of course, all kinds of problems arose, and as things evolved, new mechanisms were developed to handle them. For example, the government permitted people to buy a home for a certain subsidized price. The government later discovered that sometimes people would buy a subsidized home and then quit their job shortly after buying the home. Once the government realized this, it created a penalty for people in those positions. China has been working on these problems as they go, which is why it is important that they underwent this change gradually.

There is another important difference between the Soviet Union and China in that the Chinese Communist Party did not give up any political power. It held onto power and still maintains it today. That will continue for as long as dynastic rule and the tension of allowing economic freedom, while gripping political control, will permit it. China took this lesson from Taiwan. After the civil war ended in 1949, the Republican government of Chiang Kai-Shek retreated to Taiwan and established the Nationalist Party. The Nationalists maintained political control, as well as, central control of the economy in Taiwan. However, they realized they made a big mistake on the mainland. They understood that they had to institute land reform. They began a program that kept and built on the traditional, customary law precepts. It was called "Land to the Tiller." Legislation was passed that gave the tillers (the people who had had topsoil rights or "Land Skin" rights) title to the land. However, instead of expropriating without compensation as the communists had done, the people who had the bottom soil rights, or the land bone rights, were given shares in state enterprises. Thus one form of capital was exchanged for another, and those people were allowed to continue to participate in the economy.

Over the course of time, the Nationalist policy evolved to provide a great deal of relative freedom in the economic sector. However, it did not invite participation in the political realm. The Nationalist Party preserved politics as its exclusive domain. As the people became wealthier, and as Taiwan developed, the growing middle class started wanting more freedom. They began to question the limited political access. Over the course of time, a transition occurred and the Nationalist Party slowly began to lose power. Additionally, forces within the party pressed for reform. We saw similar events in Japan and South Korea.

China looked at the Taiwan model and compared it to the Soviet experience. The Chinese Communist Party decided to follow Taiwan's model and maintain control of the political power. Their concerns were based on the same concept articulated by Hernando De Soto—the necessity of trust in the system. What do you trust if there is no authority, no way to enforce your agreements, and no organized system for representation of ownership and predictable expansion in the marketplace. It is chaos.

A theme throughout Chinese history is “avoid chaos.” Someone must be in place to ensure the integrity of the system. Therefore, the transition to a market economy has been a gradual process. Those of you who attended university in the late 1970s and early 1980s know that people were coming out of China to study capitalism even at that time. It was laughable back then. Even though China had no plans to become capitalist, it sent its students to study how capitalism worked. It may seem odd, but the Chinese just wanted to learn as much as possible at that time. Later, those people became key in the transition to a market economy.

The Chinese government permitted people to establish their own business enterprises. Incorporating a business is now fairly straightforward, with a few odd requirements. For example, joint ventures require a feasibility study. The government is still in the middle of these transactions, protecting the Chinese party, and acting as a silent third partner. The government is supposed to substantively review and approve all new business. However, while the government does appear to look at the substance of the transactions, these days they pretty much rubber-stamp the applications. But they reserve the right to withhold approval if and when they deem necessary. Again, the government element is everywhere, and if you are a Western investor, the government's presence may be too much for you.

This brings up the issue of corruption. This morning we discussed corruption in Russia. The perception of people in China, as well as in Taiwan, is that there is corruption in the legal system. This perception is probably based upon some reality. For example, when setting up a company or representative office in China, the government regulatory authority requires the hiring of a particular agent, and that agent is usually a retired employee of the regulatory agency. The rules are very clear that a specific agency must be hired, and then paid a certain amount, even though they are not really going to assist in setting up the business. This can be seen as a form of corruption, especially from the perspective of foreigners. This requirement is certainly institutionalized. However, it is different from having to pass money under the regulatory agency's table in order to get a project approved. That happens too, but not frequently. It is more common for the Chinese to do “favors” for each other. Thus, from the Western point of view, there is corruption because Westerners are excluded. From the Chinese point of view, it is not corruption so much as dealing with people that are known and trusted.

#### IV. RULE OF LAW

Hernando De Soto seemed to say that having laws creates the Rule of Law. The West continually says that China is still working towards the Rule of Law, but they do not yet “have law.” Although China’s ancient property laws illustrate that China has a long history of written laws, the West perceives that any claim to rule of law is suspect, dubious, or outright deceptive.

In the last twenty years there have been 200 major new laws and thousands of regulations, decisions, notices, and other written rules. Clearly, law is all over the place. Then it becomes a question of what it means to have written laws. Do written laws create the Rule of Law? No, the presence of rules is not enough. The laws must be internalized by the population, and the laws must be respected and understood by the population.

An interesting contrast perhaps, showing *how* laws are internalized by a nation’s citizens is to compare traffic patterns in the United States and in China. The rules of the road in most nations are basically a copy of American rules. Since the United States had more cars at an earlier time than other nations, it was reasonable to adopt practices already made common in the United States, such as yellow divider lines, traffic lanes marked by white dashed stripes, road medians, green, yellow, red traffic lights, etc. China also adopted many of these rules. Chinese drivers must take a driving test that requires knowledge of what the lane markers mean: drive within your lane, do not drive over the line, and signal before changing lanes. But what happens when it gets really crowded? An example is the major highway between Nanjing and Shanghai. It is common that the two lanes going towards Shanghai and the other two lanes going towards Nanjing are overcrowded, producing wall-to-wall traffic for sixty miles. Due to economic scarcity, the government did not construct nearly enough lanes to accommodate the number of trucks, cars, and buses traveling on those roads. To remedy this, the drivers spread out and convert the two-lane road into a three-lane road, without any direction from the police or any government authority. The driver on the right side drives halfway on the right shoulder and half in the first lane. Another driver drives right on top of the lane dividing line, and a third drives half-way on the left shoulder. The police observe the violation, but do not interfere. There is the sense that the police do not think it worthwhile to stop this if people choose to drive this way. The people believe that the official rules do not adequately meet the situation, and the police are powerless to stop them. There are not enough police to really prevent the behavior. As a result, the police have to sit back and let it happen.

This process works well until someone’s car breaks down or there is an accident that blocks one of “the lanes.” Then there is no margin for error in this converted three-lane system. Given this flawed system, why do people think it is acceptable to change the driving rules and how does it happen? There is no big flashing announcement alerting drivers that a third lane is open due to congestion. It is like the French joke about the two German guys out walking at

two in the morning, on an empty street, who stop at a red light. They wait for the light to turn green before crossing the street. The Chinese generally find that joke pretty funny because it shows an acceptance of rules in a mechanical way, without adapting to circumstances. But does the Chinese adaptation mean there is no Rule of Law?

Another significant problem that occurs as a result of the traffic relates to pedestrians. If you go back, even just a few years ago on Changan Avenue in Beijing, the crosswalks were few and far between. Now there are pedestrian underpasses, although there are still people that do not want to walk down the stairs to the underpass and back up again. So occasionally you see somebody still trying to cross the busy roads among a sea of cars. But before the government provided infrastructure for pedestrians, how did people manage? Did people refuse to cross since the government failed to provide them the infrastructure? No, they worked out socially acceptable ways to achieve their goals. But making it across an eight-lane road filled with cars and buses is not an easy task. An individual has little chance of crossing safely. However, a large body of people can make it across more successfully. Once enough bodies get together, the group can cross safely. An individual does not dare face down a bus alone, but a bus driver would not dare kill a large group of people.

This behavior is essentially that of a collective. When a person goes ahead of the group, he risks getting smacked down, so everyone is constantly adjusting to see where everybody else is. It can be said that this is real time democracy, the rules changing as the people need them to be changed. Individuals are voting with their feet, and also adjusting their behavior to the group: How fast is the group going, and who is pushing it? Ten or twenty years ago, there was no traffic to worry about because there were so few cars in China. Instead, there were bicycles, and a mass of bicyclists who rode close together. On a whole, it worked. Every now and then there would be an injury, or a fistfight would break out. Generally, the fistfight was about someone who stepped out of whatever the consensus was for that moment. With little margin for error, the masses of bicycles required that everyone constantly adjust to the circumstances and the group. So if somebody did not adjust properly and caused injury to someone else, or moved in front in a different way than the norm, people would get angry. Within this collective, there was an understanding and arrangement of how things worked.

This is democracy in action. People make individual choices to join in a collective for a common purpose. While the highway situation was created because of economic scarcity, it is also a case of cultural differences. If you follow the stereotype, for example, it is hard to imagine German drivers on the autobahn converting the road to drive on the shoulder. But it is more than culture. This phenomenon really goes down to some foundational, fundamental understandings of a people.

When we talk about law, we talk about rules. However, when we talk about the Rule of Law, a whole package comes with it: process, and everything else. On a very fundamental basis, people believe that others think culturally differently from themselves. On a very fundamental basis, people do think differently, including perceptions about the world.

For example, American and Chinese children were shown a series of images, including a chicken, a cow, and grass. The children were then asked which of the images in the photos go together, the chicken and cow, the chicken and the grass, or the cow and the grass. A statistically significant number of American children would say the chicken and the cow go together because a chicken and a cow are both animals. On the other hand, Chinese children were statistically more likely to say that the cow and grass go together because the cow eats the grass. This test was controlled for urban populations, education levels, and children versus adults. Other studies confirmed this difference. Experiments were conducted comparing American, Korean, Japanese, and Chinese college students. In these studies, participants had the choice of a panda, monkey, and banana. They were asked which two go together. Once again, there were statistically significant differences between college educated urban Americans, and their Chinese counterparts. Once again, the Chinese, more often than not, said the monkey and the banana go together. They made this association because monkeys eat bananas. They love bananas! That is a common impression of monkeys. There is no right and wrong here. This is just how a group of people categorize something on average. Among American and European students, it is more common to look for a taxonomical rule and say, "Ah, they are all animals." They draw an abstraction from the images, not a relationship. Instead, it is a matter of associating the characteristics of the objects, and then recognizing the relationships among the objects. It seems to relate to some basic, philosophical, and foundational aspects of the way that each culture developed.

Another example involves images of a flower, leaf, and stem. The University of Michigan, where they are doing some very interesting work on this, showed this illustration to Korean, European, and Asian American students. This experiment only dealt with the educated urban populations. The participants had to decide which group of objects appeared more similar to a group of target flowers. Sixty percent of the Koreans thought that the target object was similar to the group with more instances of large petaled flowers, although there was no one rule that appeared. On the other hand, sixty to seventy percent of European Americans thought the object was more similar to the other group, which appeared to meet a strict rule about straight stems although the petals did not appear similar. The reason they gave was that the target object had a straight stem. They identified a rule.

Again, there is no right or wrong answer to these questions. Choosing one association over the other does not reflect intelligence. Experiment after experiment demonstrates that people in different cultures organize information differently. East Asians organize information differently than Westerners organize information. It

is not that they cannot think one way, or that you cannot think another way. It is just that there is the initial gut reaction, and it is more likely to be one in one culture, and another in another culture. These experiments tend to show that the Westerners abstract much more.

Here is another experiment that relates to this issue. Pre-verbal toddlers and their moms interact while the scientists watch behind a one-way mirror. The experiments highlighted a difference between Japanese and American mothers in how they interact with their children. Each mother had a ball, truck or car. The American mothers said things to the children like, "This is a toy car. This is a red toy car. Look at the wheels, they roll, etc." Japanese mothers in their interactions, tended to give the child the car and say things like, "I give the car to you. You give the car to me. I give the car to you, and you say thank you. You give the car to me and I say thank you."

The Japanese mothers' interactions were much more about the relationship. It is the difference between teaching people nouns first or verbs first. And that difference seems to come out of Western philosophy. Go back to Plato, go back to Aristotle. Within Western philosophical thought, there is an inclination that drives us to constantly look, abstract, categorize, and classify. This leads to symbolic logic. Symbolic logic leads to science. China never had science the way people in the West know science. No doubt, China had great technology, but it had no body of literature showing abstractions at the level of science. You can look and say, "These are the guys who a thousand years ago had an incredible silk industry. The Jacquard loom was supposedly the precursor to the modern day computer, and the Chinese silk weaving machines were even more complicated." The Chinese had these a thousand years before the Europeans. But one can argue that the Chinese did not step back and apply the abstract principles to other fields because there is a tropism in the culture. There is a tendency in the culture, a tipping point.

The Rule of Law is an abstract principle. Therefore, the approach will be different in China than in the West. In the United States, the system is adversarial and somebody wins and somebody loses. We get this from the Greeks. This principle can be seen in business negotiations and also in the law. There is the notion in the West that we fight for justice through the adversarial system. Justice is an abstract principle. In China, one is less likely to fight for an abstract principle. They may couch their negotiations in that way because of what they have learned, but on a whole the goal is, "Let us make a deal. Let us be practical. I give some to you, you give some to me." It is a very different approach but it goes back to how you process information. It is as fundamental as that.

Taking this back to transitions in China's market economy, this pragmatic attitude allowed the government to adjust its policies and step forward, then realize a misstep and step back. If you are somebody trying to do business in China, you know there have been a lot of crazy laws, which have been repealed. Some of them are absolutely insane by Western expectations. For example, ten years ago, a regulation provided that anyone who used foreign computer software

had to register with the police. Since China did not produce commercially viable software, every computer user had to register with police. It was an outrageous requirement. People felt it was ridiculous and so they did not register. The police could not enforce the regulation. Anybody who used Microsoft Windows, even a pirated copy, was supposed to go and register with the government. Granted, there were not nearly as many computers in China ten years ago, as there are today. But, still this was a very impractical rule.

The regulation was repealed because no one registered, making the regulation unenforceable. Later, another regulation was put in place providing that Internet users had to register with the police. Of course, the hotels were all making Internet connections for their foreign guests and so then they were stuck because the police departments told the hotels they had to put little warning signs in their rooms. So posted next to the hotel sign were announcing "We provide Internet Access," was another sign saying, "According to Regulations all Internet users must register with authorities or else be subject to prosecution, a \$30,000 fine and ten years in jail." It had a chilling effect. You were either in the camp that decided the government was really bugging your room and just trying to trap you, so you did not touch the Internet jack, or you were in the camp that said, "They cannot enforce any of their rules, so forget it. I will do what I want." That regulation was also withdrawn.

Many of the rules that have been tried have been withdrawn. In a sense, this is why the Chinese will say they have democracy. People have a chance to participate in shaping the laws. Thus, one can argue Chinese democracy does exist to a certain extent even though the Chinese do not vote on legislation with black and white pebbles as the Greeks did. There is not a plebiscite on such issues in the Greek sense. But there is a view among the educated, urban population at least, that the fact that people can have an effect is some sort of participation in Government. You will hear people occasionally say, "we have democracy with Chinese characteristics." Westerners are suspicious of the consensus because they believe that it is unnatural. Chinese people tend to think it is good to see the vast majority of folks agreeing and producing a consensus.

The Chinese government sends a large number of students to study law in the United States. On the one hand, the government authorities do not want to have a lot of lawyers because lawyers may encourage people to participate in lawsuits, which might lead to the situation in the United States. But on the other hand, authorities recognize the need to have somebody to facilitate foreign investment and make sure business transactions are smooth. They realize that lawyers help people follow the law by advising them of the contents of the regulations. The government wants to ensure that foreigners invest in China, and thus wants to make them comfortable. The Chinese government saw that Americans and Europeans use their own lawyers to structure investments, and decided that they preferred to have China regulate the lawyers interpreting Chinese law. China also has a tradition of lawyers, although the term lawyer was not used historically. In traditional China, unofficial law masters practiced. These were men, educated in

the classics and in preparation for entering the national civil service system. Some of the men that did not get posts, were between posts, or after retirement, acted as agents for others in the legal system.

For hundreds of years they basically did just what lawyers do now, drafting contracts, filing lawsuits, and advising on court cases. Granted, these cultural traditions were thrown out wholesale in the twentieth century when the Chinese tried to adopt Western models. Still, there was recognition in the late 1970s and 1980s that something had to change.

In the 1980s, China instituted a bar exam, recognizing that lawyers should be allowed to exist again. The ideal of the masses existing in harmony with each other, as guided by the party, was recognized as a failure. The State did not want to have too many lawyers, and as a result tightly controlled the bar passing rate. At the same time, there was a conscious effort that we need more legal education. The government recognized that lawyers are going to be an important part of civility, and an active and viable economy.

This was largely driven by the economic reality about the law in this area. China viewed the United States as a bad example, with too much litigation. However, they also see the beneficial role of lawyers in mediating between any authority and constituents who have to deal with authority. The mind-set is still very much top-down with the Communist Party and the central government ruling as the political force, but all of those wheels need oil.

By training lawyers, China has a cadre of people who understand the system and also believe that it is a good system. There have been discussions between the lawyers in our offices and non-lawyers. The ones who are not in the legal field tend to be much more cynical. The complaint is that there is no limit on what the government can do; the government just exercises raw power, etc. On the other hand, the lawyers have been trained to know there is a limit. For example, the lawyers usually argue that the Chinese Constitution says that Jiang Zemin can only have five years for his term as the head of Military Commission, and then he can only have a second term, but that is an absolute limit. The lawyers believe in the system more than people who are not trained in the system. A non-lawyer will say that is all nonsense. For the government, it is useful to have people believe a system is in effect and that it works. Also, in terms of keeping to some socialist ideals, lawyers are required to do *pro bono* work every year, such as providing legal advice to citizens at the Bar Association Office, answering legal help phone lines, etc. Again, the government realizes that there is not only foreign business to deal with, but also local problems, and lawyers can help address them.

Finally, the experience of the revolution has been seared into the minds of several generations of Chinese. They learned that there must be some rules and some credibility in terms of how those rules are implemented and enforced. Of course, there must be interaction between the rules and the culture in order to have an effective "Rule of Law." Having a world class set of laws will not do any good if the rules are out of sync with the norms of the society. Can you conduct

experiments all the time? Can you bring your society more in line with rules that are not backed by cultural norms? You can go back to the Skinner Box with psychologists and say, “Well, you can do positive reinforcement and negative reinforcement so that non-conformists receive negative reinforcement – such as you go to jail.” Slowly, people’s behavior will change. So how do you continue to shape people’s behavior?

China appears to have absorbed the concept now. However, there was a crazy period under Communism in which the people said, “We are going to create a new mentality. We are going to create the new man. That new person is going to think such wonderful holy thoughts; that he is going to have concern for his fellow man; and he is going to do this for the benefit of the country and for the nation and society.” The rules were never well circumscribed. They were general principles. Under the Maoist regime you would check the *People’s Daily* in the morning on the right hand side, and there would be something like this: this week your neighborhood committee will discuss applying the general principle of how to jointly work harder for the economy of our country.

So how do we apply that principle to what we are doing on a day-to-day basis? When you have such consolidated power, it can go awry. There are rules that can work well, but perhaps not without checks and balances.

## V. CONCLUSION

In conclusion, China has always had a market economy, although past and present regimes have denied it. The culture supports and understands a market economy, and this is an essential element for success as the government establishes and re-adjusts the rules for the market.

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