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RESEARCH ARTICLE



The China paradox: the endogenous relationship between law and economic growth

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ABSTRACT

An enduring paradox of China's remarkable economic growth is the lack of a well-established legal system. By drawing on the credibility thesis, this paper proposes that legal and economic reforms give rise to, and reinforce, the other and the market is underpinned by evolving institutions that are shaped by the expectations of the actors in the economy. It is thus not the form of institutions but their function that is more important in assessing institutional performance. A comparative examination of the USA at a similar stage of legal-institutional development to China provides support for an evolutionary, endogenous process. This institutional analysis will focus on key issues of economic legislation, such as corporate law, patent law and securities. Analyzing the relationship as complementary processes can help explain the paradox of strong economic growth within an under-developed system of law with potential, critical implications for institutional development in other countries.

Abbreviations: BIS: Bank for International Settlements; CBRC: China Banking Regulatory Commission; CIRC: China Insurance Regulatory Commission; CSRC: China Securities Regulatory Commission; FSB: Financial Stability Board; IPO: initial public offering; IPR: intellectual property rights; M&A: mergers and acquisitions; NYSE: New York Stock Exchange; SASAC: State-owned Assets Supervision and Administration Commission; SOE: state-owned enterprise; U.S. SEC: U.S. Securities and Exchange Commission; WTO: World Trade Organization

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1. Introduction

One of the enduring paradoxes in China's remarkable economic growth experience over the decades since 1978 is the lack of a well-established legal system supporting the increasingly decentralized marketizing economy.¹ It is a notable puzzle in that robust institutions are thought to be required both in theory and in practice to support markets.² For instance, in a Walrasian sense, a market economy is predicated on well-defined property rights and low transaction costs that permit efficient exchange to take place.³ The rapid transition experience of many other economies such as the former Soviet Union was in part predicated on the establishment of private property

rights and removal of the inefficient state in the burgeoning market economy. In China's case, however, much of its reforms have been undertaken without an established rule of law.⁴ It raises questions such as how China was able to instill economic incentives in the absence of well-protected private property rights and how an imperfect legal system could protect against expropriation that would normally limit investment and other private economic activities, particularly foreign direct investment (FDI).

The gradualist and evolutionary nature of both economic and legal reforms provide a basis for understanding the relationship between law and growth in China. The Chinese legal tradition is distinct from that of common law (UK, USA) and civil law (Continental Europe) countries; although that does not negate the incrementalist nature of legal reforms which can exist in all legal systems.⁵ Perhaps most evident in common law countries, law develops from case law, that is, judicial pronouncements which give meaning to, and shape, the interpretation of the statutory laws. Common law itself is premised on cases furthering common laws. *Stare decisis* and precedent naturally carry significant weight in judicial rulings and in shaping the development of the rule of law. Law, therefore, endogenously develops over time rather than emerges as a wholly formed system of a 'rule of law.' Even in countries with a civil law tradition, laws are evolutionary as comprehensive codification is not feasible and the state, including its administrative organs, largely takes on the interpretative role.

In the law and finance literature, this debate has started to take shape for China. Chen⁶ argues that China's financial development follows a 'crash then law' path proposed by Coffee.⁷ From a legal perspective, Coffee argues that capital market developments precede, and not follow, legal protection for shareholders.⁸ This runs contrary to the view of some economists, namely, La Porta et al. who posit that the rule of law causes financial markets to develop.⁹ Coffee offers evidence from the historical development of the USA and UK,¹⁰ where dispersed ownership by shareholders arose with the establishment of their bourses in the 19th century and legal protection for minority shareholders came afterward, largely in the early 20th century. His argument is premised on the creation of interested parties: legal reforms are enacted due to the actions of a motivated constituency that believes that it will be better protected by the proposed reforms. Therefore, he argues that the constituency must arise before it can become an instrument for legal change. Chen applies this approach to China's capital markets and shows that an interested constituency arose after the creation of the two stock exchanges in Shanghai and Shenzhen in the early 1990s which led to the Securities Law of 1999.¹¹ La Porta et al., by contrast, draw a distinction between common law and civil law countries and show that common law countries provide better shareholder protection which fosters the development of financial markets.¹² Their argument is that legal protection allows markets to develop through providing protection against expropriation and improved contracting security; therefore, law creates markets.

Allen et al. compare China against the La Porta group of countries and conclude that informal institutional arrangements, such as trust-based contracting, supplanted the role of law in fostering capital markets.¹³ This view is consistent with the institutional economics literature which views the development of institutions as an

endogenous process that is the result of interactions among actors in a society. For instance, Ho argues that these inefficient institutions have persisted throughout the reform period and must be viewed not just as state action,¹⁴ but through the prism of private actors which is evident in the area of land rights structure in China.

Thus, as law is a key institution for markets, analysing it as an evolving institution that is developed through its interaction with market players can explain the China paradox better than a simple causal relationship from either law to markets or markets to law. Capital, in the form of securities and patents, provides a good illustration of how legal institutions have evolved to shape the means of production for an economy and the concurrent impact on growth.

This paper proposes that legal and economic reforms—extending beyond financial development—give rise to, and reinforce, each other in China. Also, institutional reform, which evolved with the economy, was sufficient to instill market-oriented incentives in the absence of formal, strong legal protection. Once a market is created by law or institutional reform (e.g. administrative dictate or absence of notable prohibition), then interested constituencies and stakeholders pushed for more formal and explicit legal reforms to protect their interests. Better legal protection in turn promotes market development by providing greater security of economic transactions. Informal, trust-based relationships supplant the incomplete legal system, particularly in terms of enforcement. In this way, the complementary processes of legal, institutional and economic reform in China can explain the paradox of remarkable growth within an under-developed system of law.

This paper will argue that legal and institutional development in China should be viewed as an endogenous, evolutionary process alongside incremental economic reforms undertaken during its transition from central planning. This is not dissimilar to the experience of rich countries at a similar stage of development when their legal systems developed alongside their markets. What makes China unusual is a confluence of factors. First, it was able to establish markets within a communal property system, which highlights the importance of administrative measures and institutional reforms. Second, its transition and therefore its marketization were gradual, such that markets were not always established by laws at the outset but developed over time with experimentation of various market mechanisms, such as the ‘dual track’ pricing system and the export-oriented Special Economic Zones (SEZs). Third, it has undertaken reform and global integration during a time when international economic laws and rules extend beyond trade and into financial regulation and intellectual property rights. The external influence of laws and rules will affect expectations within and without China, particularly in emphasizing regulatory transparency and the enforcement of laws.

A comparative view of market development and legal reform will be taken of China and the USA. The comparison will aim to shed light on the extent to which it is feasible to establish a comprehensive legal system at an early stage of economic development. In the case of the early reforms of the late 1970s and early 1980s, the particular context of Chinese gradualist transition meant that institutional reform—through creating an expectation of property rights—was sufficient to instill the necessary

incentives for the development of markets. However, as markets developed, more formal and explicit legal reforms were needed and thus China began to rapidly adopt laws during the 1990s and 2000s, particularly with the additional pressures of international economic laws with World Trade Organization (WTO) accession in 2001. China's experience is unusual in the post-war period where the transition and development models are heavily tilted toward formal legal rules, but is not atypical of the experience of developed countries' legal and economic development during their industrialization at the turn of the last century.

Section 2 sets out the relationship between law and markets and the view of institutions as evolutionary in terms of their relationship with economic growth. Section 3 provides the comparative context with the USA that shows the iterative nature of market formation and economic development. Section 4 concludes that the key means of production, capital, is shaped by the interaction of legal institutions and the needs of the market.

2. Laws, institutions, and markets

2.1. Law and markets

There are both theoretical and empirical perspectives on the relationship between law and markets that drive economic growth. At first glance, it may appear that some laws are less relevant to economic growth, such as the workings of the criminal law system. However, crime may well deter investment and social stability and can be a determinant of location for risk-averse firms.¹⁵ Thus, the functioning of the legal system across its various dimensions may well be relevant for economic growth, though the focus would presumably be on civil and commercial legal developments.

From the theoretical perspective, the 'invisible hand' of the market works efficiently where there exists optimizing agents transacting in a framework of well-defined property rights and sufficiently low or zero transaction costs. Law establishes those conditions. A legal system defines the property rights and the costs of transacting and exchange. For instance, ownership recognized by law establishes the security of the private property to be exchanged. A well-functioning legal and regulatory system can ensure that transactions involving those properties take place, i.e. provide contracting security. For China, one element of the paradox is the lack of legally protected private property rights (see e.g. Jefferson and Rawski 2002).¹⁶ It was not until the Property Law of 2007 that equal protection was granted to both private and public property. Indeed, much of China's growth and reform has taken place with the state retaining ownership of enterprises, land and housing. Privatization of SOEs did not occur but gradually over three decades of market-oriented reforms. The private housing market was lately established, perhaps measured by the conclusion of housing privatization reforms in 2001. Since land remained largely in state hands, it resulted in the creation of long-term rights of use rather than freehold ownership.¹⁷

From an empirical standpoint, these theoretical insights have been incorporated into the literature advocating the importance of laws and institutions in explaining persistent economic growth.¹⁸ La Porta et al. emphasize the importance of legal origin,¹⁹ e.g. whether a country had a common or civil law system, in influencing

financial sector development and consequently economic development. China did not fit well within this framework, particularly because legal origin was based on the externally imposed legal system of the colonial powers on developing countries. But, for countries such as China which did not adopt a legal system from a particular colonial power, the legal formalism hypothesis would seem to have minimal explanatory power. Studies of other transition economies conclude that the effectiveness of laws is more important than the completeness of the written formal law for economic growth, further reducing the force of the legal origins school. One significant conclusion is that a ‘transplanted’ legal system into a neophyte transition economy—whereby the wholly formed laws of developed countries which would presumably encompass the necessary elements for a ‘rule of law’—did not work.²⁰ Glaeser et al. also emphasize the functional rule of law as relevant for growth.²¹ Therefore, the elements of a well-functioning legal system would include an independent judiciary, freedom of executive branch interference, and low risk of expropriation.²²

Institutional development was therefore considered to be important and the focus has shifted away from legal formalism and legal origin to some extent.²³ For instance, Acemoglu and Johnson emphasize two types of market-supporting institutions which are important for economic growth: property rights institutions which protect against expropriation by government, and contracting institutions which ease contract enforcement.²⁴ For China, these empirical measures also do not measure up well as compared against its impressive growth rate, giving rise to the ‘China paradox’.²⁵

Various measures of the rule of law and institutional development in China all suggest that its formal legal system is under-developed (see e.g. Allen et al. 2005; Cull and Xu 2005 for a range of indicators).²⁶ Using the World Bank’s Worldwide Governance Indicators, Table 1 shows that China ranked in the bottom 25 to 50 percentile of all countries surveyed for rule of law despite having grown more rapidly than comparable sized economies and other transition economies. For instance, China’s per capita GDP growth of 8.5% from 1980 to 2018 was faster than Brazil (just 0.95%), which ranked close to China in the rule of law indicator, and also Estonia (1.7%), which had a rule of law indicator that was higher than that of the USA. No proxy for rule of law will be perfect; though, nearly all studies conclude that China has an under-developed legal system.²⁷ When measured in terms of regulatory quality, a counterpart to an effective legal system, China fares even worse. Table 2 ranks the countries in terms of their regulatory quality, measuring the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. Whereas it ranked better than Russia and Brazil on rule of law, it ranked only better than Russia on the composite index for regulatory quality.

Tables 3–5 provide more disaggregated measures of different dimensions of the rule of law in China, as compared with other countries, namely, investor protection, contract enforcement, security of property rights and freedom from corruption. Table 3 measures the extent of investor protection as measured by the World Bank Doing Business survey from 2008, where China’s rank out of all measured countries is in the bottom half. In particular, it obtained the poorest rating on the transparency of related-party transactions (extent of disclosure index), which reflects the lack of arms-

Table 1. Rule of law.

Country	Percentile Rank (0–100)	Rule of Law Score (–2.5 to +2.5)
China	45.2	–0.40
Brazil	41.4	–0.48
France	89.5	1.31
Germany	94.3	1.77
India	57.1	0.17
Italy	60.0	0.37
Japan	90.0	1.40
Russia	19.0	–0.91
UK	93.3	1.73
USA	91.9	1.57
<i>Select Eastern Europe and former Soviet bloc countries</i>		
Albania	48.8	–0.14
Bulgaria	66.3	0.54
Croatia	61.5	0.35
Czech Republic	79.5	0.95
Estonia	92.2	1.42
Hungary	85.9	1.10
Poland	69.3	0.64
Romania	62.0	0.37
Slovakia	83.4	1.08

Source: World Bank, “Worldwide Governance Indicators,” (2006) <https://info.worldbank.org/governance/wgi/>

Note: Rule of law measures the extent to which agents perceive that the rules of society, in particular the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence, are enforced. The percentile rank places the country on a scale of 0–100 where 100 indicates a country that scored the highest possible value on the rule of law indicator. The governance score is normally distributed with a mean of zero and a standard deviation of one. Governance is better as the value increases. See Kaufmann et al. for a complete definition and discussion.⁹⁰

Table 2. Regulatory quality.

Country	Percentile Rank (0–100)	Regulatory Quality Score (–2.5 to +2.5)
Russia	35.0	–0.44
China	45.6	–0.24
India	46.1	–0.22
Brazil	53.4	–0.04
Albania	55.8	0.09
Croatia	64.1	0.43
Romania	66.0	0.48
Bulgaria	69.9	0.61
Poland	72.3	0.71
Italy	74.3	0.81
Czech Republic	80.1	0.96
Slovakia	81.1	0.99
Japan	83.5	1.05
France	85.9	1.15
Hungary	86.4	1.15
USA	90.8	1.45
Estonia	92.2	1.50
Germany	92.7	1.50
UK	98.1	1.86

Source: World Bank, “Worldwide Governance Indicators,” (2008) <https://info.worldbank.org/governance/wgi/>

Note: Regulatory quality measures the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. The percentile rank places the country on a scale of 0–100 where 100 indicates a country that scored the highest possible value on the indicator. The indicator score is normally distributed with a mean of zero and a standard deviation of one. Quality improves as the value increases. See Kaufmann et al. for a complete definition and discussion.⁹¹

Table 3. Investor protection.

	Rank	Investor Protection Index	Disclosure Index	Director Liability Index	Shareholder Suits Index
Brazil	64	5.3	6	7	3
Canada	5	8.3	8	9	8
China	83	5	10	1	4
France	64	5.3	10	1	5
Germany	83	5	5	5	5
India	33	6	7	4	7
Italy	51	5.7	7	4	6
Japan	12	7	7	6	8
Poland	33	6	7	2	9
Romania	33	6	9	5	4
Russia	83	5	6	2	7
Slovakia	98	4.7	3	4	7
South Africa	9	8	8	8	8
Ukraine	141	3.7	1	3	7
UK	9	8	10	7	7
USA	5	8.3	7	9	9

Source: World Bank, "Doing Business Database," (2008) www.doingbusiness.org

Notes: The investor protection index (measured from 1 to 10) calibrates the strength of minority shareholder protection against directors' misuse of corporate assets for personal gain. The indicators, also out of 10, distinguish 3 dimensions of investor protection: transparency of related-party transactions (extent of disclosure index), liability for self-dealing (extent of director liability index) and shareholders' ability to sue officers and directors for misconduct (ease of shareholder suits index). Countries are ranked out of 175.

Table 4. Property rights and freedom from corruption.

Protection of property rights		Freedom from corruption	
USA	90	UK	86
Canada	90	Canada	85
UK	90	Germany	80
Germany	90	Japan	76
Japan	70	France	74
France	70	USA	73
Slovak Republic	50	Italy	49
South Africa	50	Slovak Republic	47
Italy	50	South Africa	46
Poland	50	Poland	37
Brazil	50	Brazil	33
India	50	India	33
Romania	30	China	33
Ukraine	30	Romania	31
Russia	30	Ukraine	28
China	20	Russia	25

Source: Heritage Foundation, "Index of Economic Freedom," (2008) <https://www.heritage.org/index/>

Notes: Property rights are an assessment of the ability of individuals to accumulate private property, secured by clear laws that are fully enforced by the state. The index is from 1 to 100. Freedom from corruption is based on quantitative data that assess the perception of corruption in the business environment, including levels of governmental legal, judicial, and administrative corruption. The index is from 1 to 100.

length dealing and opacity in its enterprises. A comparable measure by the Heritage Foundation is that of enforcing property rights, and China fares among the worst of selected countries, as seen in Table 4.

Table 4 measures the security of property rights, both to obtain and to enforce. China has one of the least secure systems of property rights, likely due to its underdeveloped private property system that only ostensibly existed since the notion was recognized in the Constitution in 2006 and with the passage of the Property Law in

Table 5. A comparative perspective of USA and China economic and legal development.

	USA		China	
	Year	GDP per capita ^a	Year	GDP per capita ^a
Start of industrialization period	Industrial Revolution in 1820	\$1257	Central planning started in 1950	\$448
End of industrialisation period	Industrial Revolution in 1870	\$2445	End of planned economy in 1978	\$978
Anti-trust legislation	Sherman Act of 1890	\$3392	Anti-Monopoly Law of 2007	\$8788 ^b
Bankruptcy law	Bankruptcy Act of 1898 ^d	\$3780	Enterprise Bankruptcy Law of 1986 ^e	\$1597
Corporate law	Delaware General Corporation Law of 1899	\$4051	Company Law of 1994	\$2515
Securities regulator	U.S. Securities and Exchange Commission (SEC) of 1934	\$5114	China Securities and Regulatory Commission (CSRC) of 1992	\$2132
Patent law	Patent Act of 1790	\$1257 ^c	Patent Law of 1985	\$1519

^aPer capita GDP is adjusted for PPP and in 1990 U.S. dollars.⁹²

^bThis figure is from the International Monetary Fund, "World Economic Outlook," (2007) <https://www.imf.org/en/Publications/WEO/Issues/2016/12/31/World-Economic-Outlook-October-2007-Globalization-and-Inequality-20354>.

^cThe figure pertains to 1820.⁹³

^dThe Nelson Act was superseded by the Bankruptcy Code of 1978.

^eSubstantially revised in 2006.

2007, extending equal protection to private and public property. China performs better in Table 4 that measures the extent of corruption. China's degree of corruption is comparable to India and Brazil, while it fares better than Russia and the Ukraine. Overall, China ranked 126 out of 157 countries based on these and other indicators produced by the Heritage Foundation's Index of Economic Freedoms.

In summary, although no indicators are perfect, across measures of legal/institutional development, China ranks in the bottom half of countries despite being the fastest growing major economy in the world. The accumulated evidence suggests that the paradox of fast growth and poor legal system remains after decades of reform.

2.2. Institutions and development

Institutions have come to the forefront of attempting to explain economic development that is not premised on the directionality of laws and markets.²⁸ It could provide an explanation to the China paradox.

When institutions are viewed not in terms of their form but rather their function, then it becomes more apparent that it is the credibility rather than the legal and institutional forms that matter, a position also known as the 'credibility thesis'.²⁹ Grabel argues that the credibility of the institution depends on the economic and political power of those in charge rather than the formal structures that underpins it.³⁰ Ho emphasizes that institutions should be viewed as rooted in the society,³¹ rather than as formally detached, which can provide an answer to the paradox of formally weak institutions but strong growth as in the case of China. Chang stresses that there is an artificial distinction at times between formal and informal institutions, and that institutions are often the result, and not the cause, of economic development.³² The credibility thesis has been applied to the analysis of institutions in different sectors and

resources, including land,³³ slums and informal settlements,³⁴ housing,³⁵ grasslands,³⁶ mineral resources,³⁷ and water management.³⁸

For China, the institutions that support marketization, though imperfect, have emerged in its transitioning economy.³⁹ Given the gradual reform over four decades whereby the market developed over time, the legal system supporting the market economy was likewise under-developed for most of this period. Even where a law exists, it can be more symbolic than substantive, such as the Grasslands Law where the failure of implementation is due to the politics of communal property ownership rather than the formal law itself.⁴⁰ Markets were created in the absence of formal private property rights as China's transition has been largely undertaken in a communal property system. Laws therefore did not play the main role in creating markets during much of China's reform period; instead, administrative dictates and institutional reform were often more crucial. For instance, the passage of the Company Law in 1993 occurred after the start of the transformation of state-owned enterprises (SOEs) into shareholding companies, just as private firms emerged during the mid-1990s prior to the passage of the Law on Individual Wholly-Owned Enterprises in 1999.⁴¹

The development of the market in China can largely be traced to institutional reforms that evolved around an area of economic liberalization. For instance, Du and Xu argue that administrative measures created a quota system across provinces which produced a successful stock market in China during the 1990s.⁴² Not all of which were initiated by the state, but the system was adaptable, including to economic experiments which often led to the subsequent passage of law and regulations by the government, such as the Property Law of 2007. Individuals and firms, moreover, responded well to the incentives generated by administrative measures. China's strong administrative law tradition perhaps is one explanation of the willingness of the populace to rely upon such institutional arrangements instead of clearly defined property rights established in law.

Therefore, the earlier market activities were shaped by the expectations of those selling and buying in a less than formally defined market, but one that nevertheless operated on the basis of evolving societal expectations around commercial transactions in such an informal setting.⁴³ For instance, farmers sold their surplus goods on spot markets despite not having a fully liberalized price system, which did not occur until more than a decade after those early 1980s agricultural reforms. Similarly, for entrepreneurs, the lack of a law governing their corporate forms was not an impediment to growth. Rather, the liberalization of the market from the sole dominance of state-owned firms gave them the space to enter and sell goods that had been neglected by the plan, such as consumer goods.

There appears to be a complementary process between law and markets, where law neither entirely precedes market or vice versa. Institutions fill the gap and support the economy in ways that are not always formal. Of course, formal written law creates property rights in intellectual property, legitimizes corporate forms and establishes capital markets. But, informal markets can often also arise through barter or small-scale transactions or in response to some degree of market liberalization. Once the markets are established, then in both common law and civil law traditions, there is a process of interpreting and revising the laws respectively through a judicial or

legislative process. This process is driven by interested constituents vested in the markets, which can include holders of intellectual property rights (IPRs), owners of private firms, and shareholders,⁴⁴ as well as governments wishing to reform state-owned enterprises (e.g. China in the 1990s) or restore confidence in markets (e.g. the establishment of the U.S. SEC).

Countries which produce more effective laws and regulations will have better functioning markets. In both the common and civil law traditions, this process occurs over time. La Porta et al. finds that better shareholder protection is associated with higher growth rates.⁴⁵ Cull and Xu show that provinces in China with better legal protection is associated with improved firm performance.⁴⁶ Long argues that the rule of law eventually replaces relation-based governance in China in a version of the rights hypothesis which stresses that the more effective legal system predominates over time.⁴⁷

Evaluating the USA at the time of the adoption of its corporate laws, the indicators of effectiveness of laws are unlikely to be as strong as they are at present since key protections are not specified in the statute when passed, but develop over time with judicial and legislative review.⁴⁸

For the USA and China, key commercial laws were adopted at comparable levels of development, with China having done so at an earlier stage and with seemingly more impressive economic growth rates. However, the speed of setting up a market or adoption of laws does not equate to effectiveness of the legal system. The next section provides three key examples in the area of developing capital as a key means of production for the economy that illustrates the complexity of the relationship between laws and markets.

3. A comparative perspective of legal development and markets

3.1. Chinese law

The legal system in China is modeled after the Japanese civil law system.⁴⁹ The Japanese legal system was itself fashioned after the German civil law tradition during the 19th century period of the Meiji Restoration. However, strong elements of China's own legal tradition persist, particularly in terms of the emphasis on administrative law and the lack of separation between the legal and administrative systems. Adjudication was undertaken by administrative officials who acted on behalf of the Emperor in all matters of state, including deciding lawsuits. The judicial system in China today is still part of the administrative system and hence there is no effective independent judiciary.⁵⁰ As a result, procedural laws are comparatively under-developed, whilst administrative law is at the core of the Chinese legal tradition with criminal and administrative sanctions preferred for enforcement. Jones argues that this stands in contrast to the tradition of Roman law from which many Western legal systems are derived.⁵¹ As Roman law was developed primarily to resolve civil disputes amongst individuals and groups in a largely agricultural society, civil matters are central to western laws.

This mixed legal tradition renders it difficult to situate China in the comparative law and finance literature, which emphasizes the distinction between common law (USA,

UK) and civil law (Continental Europe) countries. In particular, the La Porta et al. perspective views civil law countries as less effective in promoting financial sector development than common law countries.⁵² It is because common law countries are viewed as providing better protection for investors.⁵³ Strong protection of shareholders and security holders is associated with more liquid capital markets and more dispersed share ownership. This seminal work has led to the 'law matters' thesis whereby effective legal protection is concluded to cause financial sector development.⁵⁴ This thesis has been challenged by Coffee.⁵⁵ Coffee disputes the significance of the difference between the two sets of legal traditions and goes further in arguing that market development leads to better legal protection as evidenced by the historical pattern of laws following security market developments in the USA, UK and Continental Europe.⁵⁶ He argues that the chief difference between the two legal systems is the extent of state involvement in the market. In the USA and UK, in contrast to Continental Europe, the state did not actively intervene in capital markets and instead relied on private stock exchanges to self-regulate in their own self-interest. In France, and to some extent in Germany, the state intervened frequently in the market which left no room for what he calls 'enlightened self-regulation'.⁵⁷

More generally, Coffee reiterates the pattern observed by legal scholars that laws tend to follow from market developments historically.⁵⁸ Banner surveys 300 years of legal developments and concluded that securities regulations are consistent with this pattern.⁵⁹ Pistor et al. comes to a similar assessment after surveying shareholder rights in 24 transition economies during the 1990s.⁶⁰ She concludes that legal reforms tend to be responsive to economic changes rather than precede them.

China does not fit the paradigm of common versus civil law countries; particularly as these cover only roughly 49 or less than a third of the countries in the world, virtually all of which are former European colonies.⁶¹ China's case is much closer to other transition economies as they had to re-initiate the market during the 1990s after decades of central planning.⁶² However, unlike these countries, China did not adopt a legal system transplanted from developed economies.⁶³ Instead, it developed its own legal system, which has been influenced by the legal codes of other countries, e.g. Chinese civil law has elements of German law. Nevertheless, the sequence of law and markets would remain relevant. The paradox casts doubt on the 'law matters' thesis and has implications for the progress of reform in China several decades into its marketization process.

Undoubtedly there has been a push for legal reform in China. This has derived from its global integration and membership in the multilateral rules-based trading system under the auspices of the World Trade Organization (WTO) as well as in response to domestic pressures, which led to the recognition of the existence of a 'rule of law' in the Constitution in 1999. Although on its face, the amendment appears symbolic, Clarke argues that it formally incorporates the legal system into China's system of governance.⁶⁴ Legal reform, therefore, became prominent at the same time that the private sector was also recognized as part of the socialist market economy in the amended Constitution. The latter shift culminated in the 2001 embrace of entrepreneurs in the Chinese Communist Party. This symbolic move also occurred in the midst of ongoing legal and economic reforms which had taken place since 1978, such as

establishing a Company Law in 1993 that accompanied the transformation of SOEs into corporations, adding more credence to the view that legal and economic reforms did not progress in a particular sequence but developed alongside the other.

3.2. Laws and markets: China and the USA

Although there are pitfalls with a comparative perspective, an examination of whether markets precede or follow laws in China and the USA can inform the debate over whether the rule of law is necessary before markets develop. Examining the respective legal developments at similar stages of economic development for these two countries would be informative. This is particularly the case for capital as a key means of production that is determinative for economic growth, so the focus will be on corporate laws, patents and securities.

Although Table 5 outlines the key pieces of commercial law for the USA and China as compared against the level of economic development, there are notable differences as between the two countries to consider. The first is that the U.S. common law tradition means that cases rather than legislation shape the law, though laws can certainly be amended, such as the Bankruptcy Act of 1898 which was entirely superseded by the Bankruptcy Code of 1978 which governs corporations today. This can take place in federal or state courts, and much of U.S. corporate law is state law with notable exceptions such as bankruptcy and patents which remain under federal jurisdiction. The corporation law identified in the table refers to the State of Delaware, which accounts for some half of all U.S. corporations due to its favorable climate for corporate governance.

China, by contrast, has elements of civil law and a strong administrative component, as compared with the common law and judicial review emphasis of the USA. Its laws, moreover, have to contend with the transition of its economy from the dominance of SOEs to one with private domestic and foreign enterprises, of which the latter was gradually managed through specific legislation. For instance, the USA was confronted with the 'robber barons' of U.S. Steel and other monopolists during the Industrial Revolution, which raised concern about anti-competitive practices. The 'trust busters' of the late 19th century, therefore, enacted the Sherman Act of 1890 which was geared at dismantling monopolies. China, however, did not pass an anti-monopoly law until 2007, quite late in its market transition, due the unique dominance by SOEs which accounted for over 90% of GDP in 1978 and gradually declined in importance throughout the next decades. With the creation of a more competitive market after the large-scale SOE reform of the late 1990s as well as the incursion of foreign firms after WTO accession in 2001, there was a need to ensure that monopolies did not distort the market. In China, moreover, there were numerous laws geared at managing foreign investors to control their presence in the domestic market, e.g. Chinese-foreign Equity Joint Venture law of 1979, as well as those which governed the gradual emergence of domestic private firms, e.g. Law on Individual Wholly-Owned Enterprises in 1999. Parallel laws for foreign and domestic firms resulted. Therefore, there was subsequent unification of various pieces of law governing the same issue, such as the

Contract Law of 1999 which unified the three forms of contract law that had governed domestic and foreign enterprises separately.

Examining the periods of adoption of key commercial laws harkens back to the age of industrialization. During the Industrial Revolution in 1820, the USA had a PPP-adjusted per capita GDP of \$1257, which doubled by the end of the period in 1870.⁶⁵ If China's industrialization is considered to have taken place between 1950 and 1978 under the command economy when it was transformed from an agrarian to an economy whose GDP is generated largely by industry, then both countries experienced a doubling of incomes during the industrialization process. Table 5 shows U.S. incomes doubling between 1820 and 1870 and China's incomes doubling between 1950 and 1978. However, China's GDP per capita was half of that of the USA at the start as well as at the end of its industrialization period.

The USA had a per capita GDP of around \$3000–4000 at the time of the adoption of a key body of corporate laws at the turn of the 20th century, such as anti-trust legislation, bankruptcy law and the Delaware General Corporation Law, which were all passed between 1890 and 1900 (Table 5). The comparable set of laws for China was adopted when market-oriented reforms were implemented in the mid-1980s to mid-1990s, when its per capita income was around \$1500–2500. Focusing on the main pieces of corporate law for these countries, the Delaware General Corporation Law of 1899 was adopted when U.S. per capita GDP was \$4051,⁶⁶ while China's Company Law was promulgated in 1994 when its GDP per capita was \$2515. The adoption of commercial laws at an earlier stage of economic development by China is also evident when comparing the establishment of the securities regulator in both countries. The U.S. Securities and Exchange Commission (SEC) was founded in 1934 when U.S. mean income was \$5114, while the China Securities and Regulatory Commission (CSRC) was created in 1992 when Chinese average income was \$2132. China's commercial laws came into existence at an earlier point of its economic development than the USA.

A number of reasons for this earlier adoption include the imperfect parallel of industrialization which in the USA was founded on technological breakthroughs which transformed industry, while China undertook industrialization under quite different circumstances within a centrally planned economy. Second, China under Communism and the command economy was poorer at the start and end of the process than the USA. For instance, China's per capita GDP in 1950 was less than \$500, while U.S. income in 1820 was \$1257. Third, China's laws are adopted in a context of global trade and financial rules stemming from the WTO and the international financial institutions such as the Financial Stability Board (FSB) of the Bank for International Settlements (BIS), e.g. the TRIPs or trade-related aspects of intellectual property rights agreement of the WTO which harmonizes intellectual property regimes across countries and the Basel standards of banking regulation from the BIS. Due to this trend of harmonization of international laws, there are proponents of a view that there is convergence of corporate governance systems worldwide.⁶⁷ Therefore, the expectations of the actors in the global economy include rapid implementation of commercial laws and rules to facilitate cross-border transactions, which form an external impetus for China and other developing countries to have a legal framework at an earlier stage of development.

Where China lags behind, e.g. anti-monopoly and bankruptcy laws, reflects a lack of market need because of SOEs, making it irrelevant to be concerned with competition policy or bankruptcies. Overall, China appears to have adopted legal reforms at earlier stages of economic development than the USA, making the Chinese paradox—growth without legal development—less of one. A comparison of the key laws, namely, patent law designed to foster innovation, corporate law to enable commercial activity, and financial regulation to safeguard capital markets, will highlight the complex interaction, rather than present a clear sequence, of how law and markets evolved in both the USA and China. A distinction that appears is between the *de jure* promulgation of the law on the books and the *de facto* effectiveness of the law. The relationship of the latter to markets is where the disagreement between the two schools of thought lies. Lawyers such as Coffee⁶⁸ as well as economists such as Chen⁶⁹ would argue that the laws follow markets, while economists like La Porta et al. believe that effective laws (such as providing better shareholder protection) precede market development.⁷⁰ In the comparative analysis that follows, laws appear to largely follow economic developments and thus play a market-supporting role; although overall, the pattern is that of a complementary process whereby laws create markets, markets foster a need for more and better laws, which in turn leads to more robust market development.

3.2.1. Patent laws and economic growth

Where there is some correspondence between the levels of income and legal reform as between the USA and China is in the area of patent law and the protection of intellectual property rights. As seen in Table 5, the U.S. Patent Act of 1790 was adopted when U.S. per capita GDP was \$1257, and China's Patent Law was first promulgated in 1985 when its GDP per capita was \$1519. It is often thought that international pressures persuaded China to better protect intellectual property within their borders against the risk of expropriation and thus safeguard the incentive to invent and invest in China. Interestingly, both the USA and China adopted their laws preceding that of international laws; however, the USA was a leader of international norms, whereas China revised its existing IPRs to comply with international laws.

U.S. patent law preceded the Paris and Berne Conventions of 1867 and 1871, respectively. By that time a century later, the USA had largely completed its industrial revolution, incomes had doubled and technological progress, such as the invention of the steam engine, had occurred. The breakthroughs of the two industrial revolutions of the UK during the late 1700s to early 1800s, and the USA and Germany during the slighter late period during the 1800s⁷¹ provided a strong motivation for protecting inventions. This, of course, continued in the 20th century with the promulgation of TRIPs and harmonization of IPR laws.

China's patent law also preceded the adoption of the global IPR regime but under a very different context. IPRs are governed by the WTO TRIPs agreement of 1995 and bound China upon accession to the global trade body in 2001. TRIPs governed IPRs on the dual premises of sovereignty and independence, whereby recognition and enforcement of such rights were within a country's control.⁷² TRIPs increased both the scope of the protection of IPRs and harmonized such protection worldwide among WTO members, which runs contrary to the previous regime and led to several

revisions of Chinese laws.⁷³ As such, enforcement at the level of developed countries is expected of China.

Interestingly, China grew faster than the USA after the passage of the IPR regime, despite complaints of weak enforcement in China as compared with the strong protection in the USA. In the decade or so after passage of its patent law, U.S. per capita income grew at an average of 0.9% per annum from 1820 to 1830,⁷⁴ while China grew at 6.6% from 1985 to 1995. As it was during the industrialization process, that may have led to the lower American growth rates. The different context could also have played a role. The common law tradition of the USA would result in the effective development of the law only over time. Therefore, the patent law not generating as strong growth in the USA could be due to the lack of case law affording the magnitude of protection that is evident today. By contrast, China's patent law was promulgated after it industrialized and during a period of initial transition from central planning when China undertook 'catch up' growth. Inventions require time. Unlike the USA, China can 'catch up' during a period when there already exists a number of innovations from more developed countries and thus can manage a faster process of technological adoption through imitation and incremental improvements on existing inventions.

The initial adoption of IPR protection at a similar level of economic development, though under very different contexts, could reflect a number of factors. The first is that when a society undergoes industrialization, there is a push for protection of commercial interests such as being able to profit from invention. It could also reflect the belief of government that innovation needs to be fostered in order to promote the commercialization of invention to create markets, or to generate the technological progress needed to fuel economic growth.

The adoption at a similar period of economic development could reflect the same impetus for promoting growth, though the contexts were rather different as were arguably the outcomes as a result. IPRs indeed create a market for invention, which fuels clamors for better protection within a country and across borders as global integration progresses. The process is therefore one in which property rights are created by laws, but the market itself generates the constituency to agitate for more legal protection that meets the needs of that market which in turn fuels the development of that market. The early government focus is undoubtedly due to importance of innovation in fueling long-run economic growth, which is evident in the USA and China which turned to IPRs at roughly the same level of economic development, albeit with rather different forces driving their varied aims in this area.

3.2.2. Corporate law and economic necessity

Corporate law in the USA and China both developed in response to their respective economic needs.⁷⁵ In the USA, corporation law was left to the states after the U.S. federal constitution adopted in 1789 did not explicitly govern incorporation, thus paving the way for states to adopt their own laws during the early 19th century.⁷⁶ New York was the first in 1811, followed by New Jersey, both of which largely pre-dated the U.S. industrial revolution. Industrialization, however, led states such as Delaware, which has come to dominate corporate law in the USA, to pass its general corporation law in

1899 to govern and attract the growing number of companies with the resultant fiscal benefits to the state (see Hamermesh 2006).⁷⁷

In China, the corporatization process began in the early 1990s when SOEs were in need of reform. By 1992, an estimated two-thirds of all SOEs were thought to be loss-making.⁷⁸ By creating shareholding companies out of SOEs, the corporatization process transformed these enterprises into joint stock companies owned by shareholders and therefore began the gradual process of privatization, as many SOEs retained the state as their majority shareholder even as they reformed.⁷⁹ The passage of the Company Law in 1993 and promulgation in 1994 provided a basis in law for defining the rights and obligations of shareholders. Subsequent laws created other corporate forms, such as partnerships through the Law on Partnership Enterprises in 1997 and the Law on Individual Wholly-Owned Enterprises in 1999. The coincidence of laws with economic necessity is expected insofar as laws arise to address a specific development in the market, whether it is the growth of firms in the Industrial Revolution or the creation of companies defined by shares to reform the inefficient state-owned sector.

A common perception is that the USA has, and has had, a well-defined and highly functional rule of law. However difficult that is to measure during the late 19th century, the USA common law system was developed through case law which occurs over time and thus was unlikely to have existed as a fully fledged and effective 'rule of law' at the start of the era of the corporation. In examining 10 countries of different legal origins (common law, civil law, and 'transplanted' countries such as Malaysia and Spain), Pistor et al. argue that the corporate laws at the time of adoption tend to be simple and concerned with establishing the corporation,⁸⁰ but do not address more complex issues concerning corporate governance that demarcates an effective legal system, such as shareholder protection. They find that countries, after even adopting similar corporate laws, will diverge and follow their own paths. Therefore, they conclude that the indicators of effective corporate governance, which is typically relied upon as indicative of a well-functioning legal system, tend not to exist at the outset, including in the USA which was encompassed in their study.

The evolution of corporate law is further complicated in China by its distinct legal tradition which does not rely on courts as the main institutional source of developing the legal system. Instead, legislative enactments play a larger role, in line with civil law countries such as Germany, although the administrative law tradition in China will also play a part. Nevertheless, China's company law has been in existence for only a couple of decades and the poor scores on the corporate governance indicators, which are seen as representing the effectiveness of a legal regime, likely reflect the nascent stages of its legal development.

However, China's economic development has sped up, particularly with global integration after the 'open door' policy accelerated in 1992. The rapid passage of laws and regulations during the 1990s following the Company Law, such as the unified Contract Law of 1999, M&A Law and Securities Investment Fund Law both of 2003, reflect the push to legislate and improve the effectiveness of the commercial laws to govern the fast growing marketizing economy. In a country with a civil law tradition, laws are developed through legislative action which in turn reflects the needs of the

market, much as in a common law system where case laws arise from litigants seeking adjudication of disputes arising from market transactions. For instance, WTO-mandated liberalization of capital markets led to the passage of the Securities Investment Fund Law to govern the foreign and domestic firms expected to operate in this newly opened sector. Similarly, the 'going out' strategy of Chinese firms culminated in permission being granted to private firms investing overseas, as witnessed by TCL's purchase of the Thomson brand in 2003 and which was followed by Lenovo's purchase of IBM's personal computer business two years later. The acquisition and mergers associated with commercial transactions led to a need for an M&A law. Since the first transactions were dated in the same year as the passage of the law, it is unlikely that the law provided a strong basis for M&A transactions as its scope would not have been immediately evident, though it is plausible that the same forces pushing for permission to operate in international financial markets are the same firms and government officials who viewed the 'going out' strategy as sufficiently mature to take this step.⁸¹

3.2.3. Regulatory reform supporting markets: China's CSRC and the U.S. SEC

Regulation plays a role in a legal system through providing the measures often necessary to implement laws and the apparatus with which to enforce the same. Regulatory agencies therefore oversee markets and are the source of regulations governing markets under their remit. Regulatory systems differ significantly across countries, with one key difference as between rules-based and principle-based systems, which is evident in the USA and UK respectively, though both are common law countries. In a rules-based system, the adherence to the letter of the law takes precedent whereas a principle-based system relies more on self-regulation to fulfill the spirit of the law. In both systems, however, there is a strong contrast with civil law countries where the latter is characterized by much greater state interference in markets. Coffee describes the late development of regulatory agencies in the USA and UK after the establishment of the market as the reason that such markets governed in their self-interest due to a lack of government involvement.⁸² This was described earlier as 'enlightened self-interest.' In terms of the sequence of law and capital markets for China, this ground has been well covered by Chen for China who argues that capital markets are the most evident place for the 'crash-then-law' hypothesis because they generate a politically powerful constituency to lobby for legal change given the high degree of commonality of interest among the interested parties and the ability to obtain immediately measurable benefits.⁸³ Chen details the scandals and shortcomings in the Chinese stock market which led to better regulation and protection of shareholders.⁸⁴

Examining capital market development in a comparative perspective, there is evidence of regulatory reforms that were adopted to better govern markets. The stock markets in Shanghai and Shenzhen were established prior to the regulatory agency, the CSRC in 1992, which is a pattern that is evident in the USA as well. The U.S. Securities and Exchange Commission was established in 1934 in the aftermath of the 1929 stock market crash and subsequent Great Depression which lasted until the early 1930s. The bourse, however, pre-dates the regulator. The New York Stock Exchange (NYSE) was created in 1792 when a group of stockbrokers gathered together to trade

securities on Wall Street in New York City. For the next 142 years, the NYSE operated without a central regulator until the stock market crash of October 1929. It triggered the Great Depression which was characterized by real output falls, deflation and widespread banking failure when half of all U.S. banks failed or merged between December 1930 and March 1933. President Roosevelt was forced to shut down the entire U.S. banking system.⁸⁵ Prior to the SEC, which was created by the Securities and Exchange Act of 1934, securities trading was governed by states with decentralized supervisory authority that did not extend beyond their boundaries. Following the Great Crash (known as 'Black Tuesday'), a plethora of regulations as well as the SEC came into existence in order to safeguard markets. The plight of consumers, who had lost money in the stock market and their bank deposits due to widespread banking failure without deposit insurance for savers, heralded the need for a regulator to govern and restore confidence the financial system. The SEC, therefore, was established in response to a crash in the market and charged with implementing laws to safeguard the financial sector.

China's CSRC was established just a year after the creation of the two exchanges, though it did not have a banking regulator until 2003. The China Banking Regulatory Commission (CBRC) and the CSRC were put in place to regulate the financial sector, alongside the insurance regulator (China Insurance Regulatory Commission or CIRC), following the establishment of the capital, banking and insurance markets largely in the 1990s. As discussed earlier, China scores poorly on corporate governance indicators reflecting the lack of effectiveness of the law and the imperfect oversight of China's trio of regulators. The late establishment of the CBRC in particular suggests that the banking sector had developed in the absence of regulation, which would be paradoxical except for the dominance of state ownership and therefore state control in bank lending for most of the reform period. As the banking sector became more open and the dominance of the state banks started to recede, there was a push—particularly with WTO-mandated opening to foreign banks—for a regulator and improved governance. The insurance market was also lately developed. Before the late 1990s, insurance was provided by the *danwei* or SOE work unit so a market hardly existed. With reform, the market developed and the CIRC undertook a corresponding governance role.

Regarding the CSRC, Chen documents the ways in which securities regulations were passed in response to the demands of interested constituents in the capital markets.⁸⁶ Despite the relatively early establishment of the CSRC soon after the bourses and comparatively in relation to the USA, there were no significant securities laws passed for six years until the Securities Law in 1998. Prior to its enactment, the stock markets still operated under administrative direction. Provincial governments selected firms to become listed firms and they in turn were allocated a certain quota to do so.⁸⁷ As a result of the incentives of the quota system, provincial authorities selected the better performing firms for initial public offerings (IPOs) so that the stock market grew throughout the 1990s despite the Securities Law not being in effect until the late 1990s.⁸⁸ In this way, China's capital markets functioned prior to the establishment of the relevant laws or an effective national regulator. However, WTO accession in 2001 changed the picture. As part of its WTO terms, China agreed to open its financial

sector to foreign firms. The anticipated opening led to a series of securities laws passed since 2002, which rapidly reformed China's financial sector. Foreign firms and governments interested in accessing China's market as well as the *de novo* private sector would be among those clamoring for better defined rights. The Chinese government's desire to foster its own state-owned enterprises as well as safeguard the market from foreign dominance would be among the other drivers. For instance, the State-owned Assets Supervision and Administration Commission (SASAC) was established in 2003 to oversee state-owned assets when SOEs still accounted for nearly half of China's GDP and the state maintained a 25% ceiling on foreign equity ownership for SOEs. The result was a large number of regulations which had been passed since 2002 that were geared at improving transparency, increasing disclosure requirements, reforming the non-tradable shares in the stock markets, extending protection to minority shareholders, forbidding insider trading, and monitoring mergers and acquisition activity. All of which addressed the needs of shareholders, investors, debtors, and firms in the market.⁸⁹ In turn, the growth of the market led to the need for regulation and regulators which, if they were effective, would lead to further development of the capital markets. After the establishment of the SEC in 1934, the NYSE experienced its longest bull market of eight years from 1949. Although the same cannot be said of the CSRC in its first decade and a half, the numerous securities laws passed since greater market opening after WTO accession have heralded significant reform and periods of performance of the stock market in China.

3.3. Comparative laws and markets

In China's financial sector, the sequence seems to be one of markets preceding laws. Laws appear to develop alongside, and in response, to market needs. As in the USA, laws and regulations were not established in a vacuum nor predated market development. Instead, some laws (and administrative dictates in China such as the provincial quota system for IPOs) create markets, which gives rise to further laws and regulatory bodies which in turn govern and establish new segments of the market. Therefore, it seems that whether it is 'crash and pass' like the U.S. SEC and the reforms of China's capital markets, or a more evolutionary process to accompany economic reform such as the Company Law and associated corporatization movement in China and the Delaware Corporation Law after the U.S. industrial revolution, or the passage of IPRs to promote technological advancement in both countries, the process is better characterized as complementary rather than sequential or cause and effect.

4. Assessment of the law and economic relationship

This paper has examined several aspects of the relationship between law, institutions and economic growth in China. The relationship between law and markets appears asynchronous for China. The argument that laws and market development reinforce each other was made through an examination of the experience of the USA at a similar stage of economic development. By comparing three facets of Chinese and American legal reforms in the area of capital markets—intellectual property protection,

corporate law and securities regulation—the pattern was largely evolutionary in that laws may have created a market in the case of IPRs and enabled corporations, but regulations which gave substance to the law and therefore its effectiveness generally were passed after there was an evident economic necessity, such as abuse of monopoly power or financial sector scandals. Therefore, although a law or administrative dictate (or absence of strict prohibition) may create a market (or an informal one), this factor is insufficient to argue that the sequence must be laws preceding markets. Even innovation can happen without IPRs. By the yardstick of whether an effective rule of law exists, which goes beyond just the provisions that create an IPR or a corporate form, laws appear to develop in response to market demands and needs, which in turn leads to more marketization and economic development.

It is difficult, if not impossible, to fit China into any paradigm given its history and context. However, China's experience suggests that there are more parallels than would at first appear between its legal and economic development with the USA. Specifically, China's legal development is similar to the USA, but at a comparable time in their economic development. By comparing the development of capital, a key means of production for the economy, the corporate sector can be viewed as illustrative of the endogenous and iterative nature of institutions and their relationship to economic growth.

This perspective reconciles the existing views in the literature by arguing that laws both precede and follow markets, and the role of evolving institutions must not be overlooked. Thus, this paper posits that the literature is describing different facets of an evolving picture. That context is heavily dependent on understanding the role of institutions that can reconcile the China paradox of strong growth despite weak, formally measured or calibrated laws once its effective institutions are considered.

In conclusion, China's path will be enticing for many developing countries for which it is not unusual to have a nascent legal system that will not rate well in terms of effectiveness or enforcement. The experience of China will highlight the need to give greater recognition to the function of institutions that result from the interactions of society's actors rather than focus on a desired institutional form.

Notes

1. Allen et al., "Law, Finance and Economic Growth," 57–116; Cull and Xu. "Institutions, Ownership, and Finance," 117–146.
2. North, *Institutions, Institutional Change, and Economic Performance*; Acemoglu and Johnson, "Unbundling Institutions," 949–995.
3. Coase, "The Nature of the Firm," 386–405.
4. Xu et al., "Politician Control, Agency Problems," 1–24; Gan et al., "Decentralized Privatization," 3854–3894.
5. See Jones (2003) for the modern day influences of China's dynastic legal system.
6. Chen, "Capital Markets and Legal Development," 451–472.
7. Coffee, "The Rise of Dispersed Ownership," 1–82.
8. Ibid.
9. La Porta et al., "Legal Determinants of External Finance," 1131–1150; La Porta et al., "Law and Finance," 1113–1155. See also Acemoglu et al. (2005) for a similar argument regarding institutions and economic growth.
10. See note 7 above.

11. See note 6 above.
12. See note 9 above.
13. Allen et al., "Law, Finance and Economic Growth," 57–116.
14. Ho, "In Defense of Endogenous," 1087–1118.
15. Brock, "Foreign Direct Investment," 349–360.
16. Jefferson and Rawski, "China's Emerging Market," 585–617.
17. Ho, *Institutions in Transition*.
18. Rodrik et al., "Institutions Rule," 131–165.
19. See note 9 above.
20. Pistor et al., "Law and Finance in Transition," 325–368.
21. Glaeser et al., "Do Institutions Cause Growth?" 271–303.
22. Pistor and Xu, "Governing Stock Markets," 184–127; Fan et al., "Institutions and Foreign Direct Investment," 852–865.
23. Aron, "Growth and Institutions," 99–135; Rodrik et al., "Institutions Rule," 131–165.
24. See note 2 above.
25. Cull and Xu, "Institutions, Ownership, and Finance," 117–146; Lu and Yao, "The Effectiveness of the Law," 763–777; See note 15 above.
26. See note 1 above.
27. Yao and Yueh, "Law, Finance and Economic Growth," 753–762.
28. Aron, "Growth and Institutions," 99–135.
29. Ho, "The 'Credibility Thesis'," 13–27; Ho, *Unmaking China's Development*.
30. Grabel, "The Political Economy," 1–19.
31. Ho, "The 'Credibility Thesis'," 13–27.
32. Chang, *Institutional Change and Economic Development*.
33. Clarke, "Form and Function," 902–912; Koroso et al., "Land Institutions' Credibility," 553–564.
34. Zhang, "The Credibility of Slums," 876–890; McClymont and Sheppard, "Credibility without Legitimacy?" 102520; Oranje et al., "Rapid Urbanisation to Non-Metropolitan Urban South Africa," 102487.
35. Celhay and Gil, "The Function and Credibility," 102605.
36. Zhao and Rokpelnis. "Local Perceptions of Grassland," 1206–1223; Fan et al., "Institutional Credibility Measurement," 212–225.
37. Fold et al., "Grounding Institutions," 922–931.
38. Gomes and Hermans, "Institutional Function and Urbanization," 932–941.
39. Young, "The Razor's Edge," 1091–1135.
40. See note 18 above.
41. Du and Xu (2009) argue that administrative arrangements took the place of laws in creating China's capital markets.
42. Du and Xu, "Which Firms Went Public," 812–824.
43. See Thelen (2002) for a review of the historical institutionalism literature that points to the path dependence of institutions.
44. See note 7 above; Sun and Tobin, "International Listing as a Means," 825–838.
45. La Porta et al., "Legal Determinants of External Finance," 1131–1150.
46. Cull and Xu, "Institutions, Ownership, and Finance," 117–146.
47. Long, "Does the Right Hypothesis," 629–650.
48. Pistor et al., (2003) provide a historical review of common and civil law countries that finds that countries do not have strong rule of law at the inception of their laws. Instead, effectiveness as measured by shareholder protection develops over time. Acemoglu, Johnson, and Robinson (2005) instead argue that countries which inherited better institutions, i.e. those that protected against risk of expropriation, from colonial powers had higher growth rates in subsequent years due to the positive impact of those institutions.
49. Jones, "Trying to Understand," 91–107.
50. Alford, *The More Law*,

51. Jones, "Trying to Understand".
52. See note 9 above.
53. La Porta et al., (1998) draw the further distinction that civil law countries such as German and Scandinavian ones provide better protection than French civil law countries, though not as much as common law countries in a survey of 49 countries.
54. Levine, "Financial Development and Economic Growth," 688–726; Levine, "The Legal Environment," 596–613.
55. See note 7 above.
56. Ibid.
57. Ibid, 9.
58. See note 7 above.
59. Banner, "What Causes New Securities," 849–855.
60. See note 21 above.
61. Acemoglu et al., "Institutions as the Fundamental Cause," 385–472.
62. Pistor and Xu, "Governing Stock Markets," 184–127.
63. Pistor et al., "Law and Finance in Transition," 325–368; Berkowitz et al., "Economic Development, Legality," 165–195.
64. Clarke, *China: Creating a Legal System*.
65. Maddison (2001) provides historical GDP per capita measures reported in 1990 US dollars.
66. There had been corporation law prior to the Delaware Act, though the dominance of Delaware as a preferred state for incorporation lends itself to be identified as a key article of U.S. company law (Hamermesh 2006).
67. Hansmann and Kraakman, "The End of History," 439–468.
68. See note 7 above.
69. See note 6 above.
70. See note 9 above.
71. The steam engine, spinning and weaving machines, cast iron, and electric battery were among the key inventions of the 19th century industrial revolutions. In the 20th century, the international conventions on patents occurred during a time of inventions, such as the telegraph, telephone, and electricity, which coincided with a five-fold increase in per capita incomes in Western Europe as compared with the three-fold increase between 1700 and 1800 (Maddison 2001).
72. Yueh, "Global Intellectual Property Rights," 436–448.
73. The 164 members of the WTO account for nearly the totality of world trade.
74. Per capita GDP for the U.S. is not available in 1790, so the next available data from 1820 is reported.
75. See Horwitz (1992) for the evolution of U.S. contract law during the late 19th and 20th centuries in response to the economic and social conflicts of the time.
76. The presumption of the U.S. federal system is that unless explicitly claimed in the Constitution or Act of Congress, an area of law was to be governed by state law. The "state's rights" doctrine is embodied in the 10th Amendment concluding the Bill of Rights to the U.S. Constitution, which states: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."
77. Hamermesh, "The Policy Foundations," 1749–1792.
78. Fan, "Incremental Change and Dual-Tack," 99–122.
79. Clarke, "Corporate Governance in China," 494–507.
80. Pistor et al., "The Evolution of Corporate Law," 791–871.
81. See Sun and Tobin (2009) for the argument that innovative Chinese firms can enter and learn from international capital markets, which in turn can induce market-level improvements through regulatory competition and demands for a more standardized system of economic regulation.
82. See note 7 above.
83. See note 6 above.

84. Ibid.
85. Bernanke, *Essays on the Great Depression*.
86. See note 6 above. See also, Sun and Tobin (2009).
87. Du and Xu, *Regional Competition*.
88. Du and Xu, "Which Firms Went Public," 812–824.
89. See note 6 above.
90. Kaufmann et al., *Governance Matters VI*.
91. Kaufmann et al., *Governance Matters VI*.
92. Maddison, *The World Economy*.
93. Maddison, *The World Economy*.

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