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A Tale of Two Chinese Courts: Economic Development and Contract Enforcement

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The way in which formal contract enforcement becomes effective is a critically important but understudied question for law and development studies. Primarily drawing on field investigations, this article compares the enforcement performance of two basic-level courts in China, one in a more-developed and the other in a less-developed region. The level of economic development is found to be crucial in contributing to the courts' performance. Unlike the court users in the less developed area, those in the more developed area become more market-oriented as the local economy diversifies, paving the way for more rigorous judgment enforcement; a developed local economy also allows the court to strengthen institutional building and staff professionalism. The comparison of the two Chinese courts provides empirical evidence with which to evaluate the relationship between formal contract enforcement and economic development.

While contract enforcement by Chinese courts has been regarded as notoriously difficult,[1] several recent studies have challenged this long-held

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1 D.C. Clarke, 'Power and Politics in the Chinese Court System: The Execution of Civil Judgments' (1996) 10 *Colum J. of Asian Law* 1–125; M. Pei, 'Does Legal Reform Protect Economic Transactions? Commercial Disputes in China' in *Assessing the Value of Law in Transition Economies*, ed. P. Murrell (2001) 180–210; M. Trebilcock and J. Leng, 'The Role of Formal Contract Law and Enforcement in Economic Development' (2006) 92 *Virginia Law Rev.* 1517–80, at 1519; M. Moser (ed.), *Managing Business Disputes in Today's China: Duelling with Dragons* (2007); J.A.

belief. Drawing on the national statistics for three types of formal contract transactions, Yu and Zhang,[2] for example, argue that commercial parties are able to use formal legal enforcement mechanisms to provide contract protection. Empirical studies based on randomly selected cases also suggest many positive developments in enforcement.[3] Whiting, for instance, finds 'the courts play a moderately important role in the strategies firms employ',[4] and 'courts are not as completely flawed as they have been portrayed' and 'are an increasingly important element in the process of dispute resolution.'[5] A study on property and commercial litigation contends that 'Shanghai courts appear to be performing relatively well in that the final outcome matches most corporate litigants' expectations of a subjectively fair and positive outcome.'[6] Another researcher suggests 'the enforcement situation ... seems fairly good; and local protectionism ... seems to be contained within legal rules.'[7]

As the evidence suggesting these positive developments continues to emerge, less explored, however, are the mechanisms behind these developments. Michelson and Read,[8] in asserting the powerful influence economic development has on the legal system, admit that their survey data do not allow them to identify concrete mechanisms behind the association. Whiting only mentions the issue in passing; she speculates that the reasons for the increasing importance of the courts in dispute resolutions are because:

> [C]ontracts are often not grounded in social networks, but rather occur more at arm's length. Institutional alternatives to courts ... appear to be unavailable ... The role of the government bureaucracy in directly supervising contracts has declined markedly.[9]

Cohen, 'Reforming China's Civil Procedure: Judging the Courts' (1997) 45 *Am. J. of Comparative Law* 793–805; S. Lubman, *Bird in a Cage* (1999).

2 G. Yu and H. Zhang, 'Adaptive Efficiency and Financial Development in China: The Role of Contracts and Contractual Enforcement' (2008) 11 *J. of International Economic Law* 459–94.

3 R. Peerenboom, 'Seek Truth from Facts: An Empirical Study of Enforcement Arbitral Awards in the PRC' (2001) 49 *Am. J. of Comparative Law* 249–327; M. Pei et al., 'A Survey of Corporate Litigants in Shanghai' in *Judicial Independence in China*, ed. R. Peerenboom (2010); X. He, 'Enforcing Commercial Judgments in the Pearl River Delta of China' (2009) 52 *Am. J. of Comparative Law* 419–56.

4 S. Whiting, 'Contracting and Dispute Resolution among Chinese Firms: Law and Its Substitutes' in *Dynamics of Local Governance in China during the Reform Era*, eds. T.K. Ling and Y.H. Chu (2010) 181–224, at 193.

5 id., p. 210.

6 Pei et al., op. cit., n. 3, p. 227–8.

7 X. He, 'Debt-Collection in the Less Developed Regions of China: An Empirical Study from a Basic-Level Court in Shaanxi Province' (2011) 206 *The China Q.* 253–75, at 273.

8 E. Michelson and B.L. Read, 'Public Attitudes toward Official Justice in Beijing and Rural China' in *Chinese Justice: Civil Dispute Resolution in Contemporary China*, eds. M. Woo and M. Gallagher (2011) 169–203, at 195.

9 Whiting, op. cit., n. 4, p. 210.

While changes inside and outside the courts may affect the performance of the courts in enforcing contracts,[10] little is known about the dynamics among them. Nor do we know much about the driving forces behind these changes.

These mechanisms and dynamics are critical because they are directly related to what reform measures are appropriate in a given context, and they are related to how the quality of legal institutions can be enhanced, a central issue in the law and development literature.[11] But as North asserts:

> [T]he problems of achieving third-party enforcement of agreements via an effective judicial system ... are only imperfectly understood and are a major dilemma in the study of institutional evolution.[12]

Generations of scholars have documented the impact of a series of variables that may affect the strength of formal contract enforcement,[13] and until only recently, the literature seems to agree that economic development plays a crucial role in improving the quality of legal institutions.[14] While they provide important top-level data, the mechanisms behind this association are still yet to be identified and micro-level studies on the evolution of legal institutions remain rare.[15]

These mechanisms and dynamics are also central in exploring the relationship between formal contract enforcement and economic development. Economic actors need some assurances that contracts will be enforced before they will expend effort, invest, and bear risk. These assurances can come either from the formal system or through informal practices, but a credible, low-cost, formal contract-enforcement mechanism provided by the state has been widely regarded as essential for economic development.[16]

10 G. K. Hadfield, 'The Many Legal Institutions that Support Contractual Commitments' in *Handbook of New Institutional Economics*, eds. C. Ménard and M.M. Shirley (2005) 175–203.

11 K.E. Davis and M.J. Trebilcock, 'Legal Reforms and Development' (2001) 22 *Third World Q.* 21–37.

12 Hadfield, op. cit., n. 10, p. 175, citing D. North, *Institutions, Institutional Change, and Economic Performance* (1990).

13 A. Greif, 'Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders' (1989) 49 *J. of Economic History* 857–82; A. Greif, 'Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders' Coalition' (1993) 83 *Am. Economic Rev.* 525–48; J. McMillan and C. Woodruff, 'Private Order under Dysfunctional Public Order' (2000) 98 *Michigan Law Rev.* 2421–58; K. Hendley et al., 'Law, Relationships and Private Enforcement: Transactional Strategies of Russian Enterprises' (2001) 52 *Europe-Asia Studies* 627–56; Pei, op. cit., n. 1; World Bank, *Doing Business in 2004: Understanding Regulation* (2003); Hadfield, id.

14 A. Chong and C. Calderón, 'Causality and Feedback between Institutional Measures and Economic Growth' (2000)12 *Economics and Politics* 69–81; R. Rigobon and D. Rodrik, 'Rule of Law, Democracy, Openness, and Income: Estimating the Interrelationships' (2005) 13 *Economics of Transition* 533–64.

15 K. Hendley, 'The Rule of Law and Economic Development in a Global Era' in *The Blackwell Companion to Law and Society*, ed. A. Sarat (2004) 605–23.

16 M. Weber, *Max Weber on Law in Economy and Society*, ed. M. Rheinstein (1954); D. North, *Institutions, Institutional Change, and Economic Performance* (1990); O.

This is because such a formal, low-cost, and effective enforcement mechanism allows economic actors to expand their transactions beyond close-knit communities; in modern times, such expansion is indispensable for economic development.

However, these assertions have been seriously disputed in the debates about China's legal and economic development. Although China's economy has developed at a rapid pace during the past three decades, until recently the evidence has suggested that China was far from establishing a neutral and effective formal adjudicating body.

At one end of the spectrum are the explanations which try to fit China's situation into an economic framework. According to these explanations, the answer to the puzzle of China's growth without a sound legal system is simply that China's economy remains undeveloped. At this level, alternative mechanisms, such as cultural, religious, and ethnic norms, and the state's commitment to economic reforms, may accomplish the task of contract enforcement. The importance of the legal system has not yet been clearly demonstrated.[17]

At the other end of the spectrum are those who contend that development in China has substantially challenged the assertions of Weber and North. Although they see a formal legal system and economic development in China as a bi-directional or co-evolutionary process, there is no way to prove that the formal legal system has been essential to China's economic development; if anything, it is the success of economic development that has led to the development of the legal system, not the other way around.[18] They argue that, when the economy develops, it creates more market demand for a formal legal system;[19] this demand led to a more formal and mature legal system under the reform period. The better results in contract enforcement, if true, are simply a vindication of such market demand.

Against this backdrop, the recent development of formal contract enforcement in China constitutes an invaluable case to study. In its rapid economic development, China has made concerted efforts to reform its court system. Drawing on the author's field investigations and complemented by secondary materials, this article compares the contract enforcement performance of

Williamson, *The Economic Institutions of Capitalism* (1985) 2; O. Williamson, *The Mechanisms of Governance* (1996) 332; T. Ginsburg, 'Does Law Matter for Economic Development? Evidence from East Asia' (2000) 34 *Law & Society Rev.* 829–56.

17 D. Rodrik, 'Introduction' to *In Search of Prosperity: Analytic Narratives on Economic Growth*, ed. D. Rodrik (2003) 8–15; K. Dam, *The Law-Growth Nexus* (2006); Trebilcock and Leng, op. cit., n. 1.

18 D.C. Clarke, P. Murrell, and S. Whiting, 'The Role of Law in China's Economic Development' in *China's Great Economic Transformation*, eds. T. Rawski and L. Brandt (2008) 375–428.

19 K. Pistor and P.A. Wellons, *The Role of Law and Legal Institutions in Asian Economic Development 1960–1995* (1999).

two basic-level courts – one in a richer and the other in a poorer area of China. These courts were chosen because the lower courts have the most contact with the person in the street and because the lower courts handle by far the larger volume of contract enforcement. Two courts in regions at different levels of economic development are chosen to show the impact of this distinction. The article argues that economic growth has a direct link to both the demand and supply sides, affecting the performance of contract enforcement. Factors on the demand side include the development and diversification of the local economy, while factors on the supply side are the institution building and staff professionalism of the courts. While the same judicial reform measures have been launched in both courts, the extent of economic development has significant implications for contract enforcement. The article finally argues that legal development is not solely driven by economic factors; the courts' institutional capacity becomes strengthened when political concerns are combined with sufficient financial resources.

This article will begin by describing the reform measures of China's judiciary in improving contract enforcement. It will then introduce the two courts – the fieldwork sites – and the method of data collection. After presenting the empirical evidence, the article will explore the theoretical implications for the relationship between formal contract enforcement and economic development.

JUDICIAL REFORMS IN IMPROVING ENFORCEMENT

As a response to economic liberalization and reforms, the Supreme People's Court (SPC) has issued three five-year reform outlines since 1999, intended to improve the performance of the judiciary. Of these measures, many have been designed specifically to pacify widespread complaints against its poor enforcement record. While the ideological emphasis of mediation has shifted back and forth, these reforms have steadily taken place at both institutional and personnel levels.[20]

Institutionally, the foremost measure in enforcement is to set up a separate and relatively independent enforcement bureau within the courts. Until the 1990s, enforcement was not separate from the adjudications and was conducted by the adjudication staff.[21] After the separation, it became a

20 M. Woo, 'Law and Discretion in the Contemporary Chinese Courts' (1999) 8 *Pacific Rim Law & Policy J.* 581–615; M. Woo and Y. Wang, 'Civil Justice in China: An Empirical Study of Three Provinces' (2005) 53 *Am. J. of Comparative Law* 911–40; H. Fu and R. Cullen, 'From Mediatory to Adjudicatory Justice: The Limits of Civil Justice Reform in China' in *Chinese Justice: Civil Dispute Resolution in Contemporary China*, eds. M. Woo, M. Gallagher, and M. Goldman (2011) 25–57.

21 J. Zhu (ed.), *Zhongguo falü fazhan baogao (1979–2004)* [China Legal Development Report (1979–2004)] (2007).

division equal in the administrative hierarchy to other divisions. In the last decade, the enforcement division has been elevated to the rank of a bureau, where the director usually has the same rank as a vice-director of the courts. This means that more resources are available for enforcement.

The courts have also implemented the civil adjudicating procedure reform, separating adjudication from petition filing and judgment enforcement in a way which standardizes and streamlines the civil procedure.[22] The reform is intended to trace the progress of cases being enforced and also to hold individual judges accountable for their assigned cases. It also tries to limit corruption by dividing power. Furthermore, as an initiative by the SPC to promote greater judicial independence, the position of Chief Adjudicator has been created.[23] Under this initiative, the power to decide cases is to be vested in a chief adjudicator rather than in divisional heads or court presidents.

On the personnel level, the most important step toward staff professionalism is the raising of the threshold for the recruitment of entry-level judges by the National Uniform Judicial Exam. According to the requirement, passing this exam is a prerequisite for becoming an entry-level judge. In addition, current court staff who have not passed the exam are not eligible to become adjudicators. The courts have thus tried to recruit more judges from the ranks of law school graduates and experienced lawyers rather than from discharged military personnel, previously an entrenched practice. The judiciary has also imposed strict behaviour requirements on court staff. In addition to the general requirements specified in the Judges Law,[24] more detailed regulations, such as measures for holding adjudicating staff responsible for wrongfully deciding cases, have been issued by courts across the country.[25] There are also internal requirements pertaining to the working style of court staff, some of which are quantified by the complaint and appeal rates. In many courts, the career and income of judges will be directly affected by these rates.[26]

22 SPC (Supreme People's Court), 'The Outlines of Five-Year Reforms' (1999) Promulgated by the SPC on 20 October 1999; Woo and Wang, op. cit., n. 20.

23 Article 18 of The Five-Year Reform Outlines states: 'The court decisions shall be rendered by the chief adjudicator or the sole adjudicator according to the law by 2000' (SPC, id.).

24 See Articles 32–35 of the Judges Law of the PRC, amended in 2001.

25 Mingpao, 'Responsibilities for Wrongfully Decided Cases in a Chongqing Intermediate Court', Mingpao Section A15, 4 September 2007.

26 X. He, 'Routinization of Divorce Law Practice in China: Institutional Constraints' Influence on Judicial Behaviour' (2009) 23 *International J. of Law, Policy and the Family* 83–109.

Of the two courts surveyed, the urban one is located in the booming Pearl River Delta, the heart of coastal Guangdong province (Court G); the rural one is in the south of hinterland Shaanxi province (Court S), in western China. Cities G and S where the two courts are situated, are in stark contrast in terms of geographical location, population, and the type and amount of economic development.

Table 1. Basic information about Cities G and S in 2005

Research Site	GNP per Capita (RMB)	Percentage of Agriculture	Population (Millions)	Commercial Cases	Budgeted Funding per Court Staffer
G	57714	5.8%	1.07	~1500	~300,000
S	3069/8780*	45.0%	0.42	~300	~28,000

* This indicates the income of rural and urban residents respectively. No corresponding figures are available for City G.
Sources: The socio-economic information comes from local annals of the two cities; information about the courts comes from the author's fieldwork investigation.

The economy of City S grew during the initial stage of the reform period, but has stagnated since the 1990s. By 2002, the GDP per capita had reached only 5,226 yuan (CNY). Agriculture has been the pillar industry, thanks to the fertile valleys formed by the Wei and Jing rivers and a climate congenial to crops such as wheat. While many state-owned enterprises (SOEs) have been restructured and privatized, they remain a major player in the local economy. Of the 22 billion yuan GDP generated by large-scale enterprises, SOEs still contributed one-third in 2002.[27]

The policy, 'Separating Income and Expenses', one of the most important policies affecting the financial relationship between the courts and local government,[28] has never been implemented in this court. This is because the fees that the court collects cannot cover its own costs, so the financial bureau of the local government has never bothered to implement the requirement. As a result, the operating expenses of the court come largely and directly from litigation fees and fines imposed on criminal defendants. These amounted to about three million yuan a year before 2007 when the new

27 All socio-economic information comes from local annals.
28 Zhu, op. cit., n. 21; X. He, 'Court Finance and Court Reactions to Judicial Reforms: A Tale of Two Chinese Courts' (2009) 31 *Law & Policy* 463–86.

litigation fee guideline was enforced.[29] The litigation fees then were 100 per cent higher than the original levels stipulated by the SPC guidelines. It therefore had a great incentive to increase the sums it took in litigation fees, especially because it had a 7.8 million yuan bill arising from the construction of its new office building. Court staff were thus assigned a quota of litigation fees to be achieved; to meet this quota, some judges scouted around for potential cases, a phenomenon widely recorded in other less developed regions.[30]

Since it was directly tied to the court's finances, the income of court staff was quite low compared with that of their counterparts in the more developed regions. This low level of income certainly had some impact on the structure and the quality of the court staff. As of 2004, the courts, with 111 staff members, including those in two dispatched tribunals, heard more than 2,000 cases. Approximately 60 per cent of these staff members had a bachelor's degree; around 30 per cent consisted of discharged army officers. The number two division of the court, which handled debt collection cases, had eight employees, all of whom held a bachelor's degree. The enforcement bureau had 16 employees, eight of whom held a bachelor's degree.

In contrast, City G has a very developed and diversified economy. It is not one of the four Special Economic Zones designated to develop economy under flexible governmental measures, but it is, historically, a near neighbour of Hong Kong and Macau and, subsequently, is China's frontier for the Reform and Opening-Up policy introduced in the late 1970s. It has thus long enjoyed preferential treatment and polices. Of the 1,314 kilometres of its jurisdiction, most have been urbanized and industrialized. The population was 960,000 in 2002, in addition to 670,000 registered internal migrants who mostly came from hinterland provinces. These migrants are certainly a cheap source of workers for all kinds of labour-intensive enterprises in City G. The regional economy has become highly diversified. Many SOEs were privatized and restructured in the 1990s, and have lost their traditional dominant role. Foreign-investment enterprises, including those from Hong Kong and Macau, are distributed throughout the city. Local government revenues have come more from taxing the private sector than from SOEs and collective enterprises. With a GDP of 43,889 yuan per capita in 2003, City G is one of the most affluent regions in the country. With about 240 staff members, most of whom hold a law degree, Court G hears an estimated 20,000 cases of all kinds each year. The workload is thus quite heavy.

This research was conducted under the following conditions. In each place, I randomly selected about 100 debt-collection cases between

29 State Council, 'The Measures for Taking Litigation Fees' (2006) issued 19 December 2006, implemented 1 April 2007.

30 Y. Liao and S. Li, 'Woguo minshi susong feiyong zhidu zhi yunxing xianzhuang' ['The Current Operational Status of the System of Civil Litigation Fees in China'] (2005) 3 *Zhongwai faxue* [*Peking University Law J.*] 304–27.

economic entities,[31] according to the sequence of the filing numbers.[32] There are two reasons for this choice. One reason is that they are the most common types of commercial contract litigation in Chinese courts. As shown, three major mini-categories of commercial contract cases – purchase and sale, money lending, and contract out in rural areas – are all related to debt collection and they accounted for more than 65 per cent of all commercial cases.[33] The way in which these cases are enforced will reveal the relationship between commercial activities and court performance. Moreover, unlike cases of, for example, real estate, regular commercial debt-collection cases are more difficult as regards locating the defendants' assets, thus serving as a better indicator of the performance of the courts in contract enforcement. When a selected case did not involve non-payment, it was replaced with the one following it in the docket.

I then obtained key information about cases, (for example, nature, parties, subject matter, adjudication duration, and results) from the judgments or awards. I then conducted an in-depth investigation by phoning the parties involved and asking them about the actual amounts of debt collected through the formal process, the energy and time spent on the case, and their impression of the courts. The object was not to locate a representative sample, but to obtain the parties' experience and their perception of the court performance. As not all of the litigants were available from the information obtained through the court file,[34] I interviewed only 66 litigants in Guangdong and 60 in Shaanxi.

To arrive at a more comprehensive picture, some six judges who had been adjudicating and enforcing the judgments were interviewed in each place. I asked them what factors inside and outside the courts had prevented the judgments from being enforced, what their experiences were in facilitating voluntary withdrawal and judicial mediation, and what effects the judicial reforms had had on enforcement.

31 Debt-collection cases between individuals are thus not included.

32 The cases from Court G were completed in 2002 while the ones from Court S were from 2004. This is because the earliest year of the available docket was 2004 when I reached Court S in 2007.

33 X. He, 'The Recent Decline in Economic Caseloads in Chinese Courts: Exploration of a Surprising Puzzle' (2007) 190 *The China Q.* 352–74.

34 The reasons for unavailability include invalid or outdated contact information, and missing or deceased litigants. A tiny proportion of litigants simply declined to answer questions. There were no abnormal patterns of characteristics among the litigants who were not accessible.

ECONOMIC DEVELOPMENT AND CONTRACT ENFORCEMENT: EMPIRICAL EVIDENCE

This section answers the key questions: how do the positive developments mentioned at the beginning of the article occur? What are the forces behind them? What explains the discrepancies between the developed and the underdeveloped regions? The conclusion is that economic development plays a key role in the process.

1. *Level of economic development*

A difference in economic development means a difference in the nature of the economy itself. In the Pearl River Delta study, a local government work report showed that the industry and commerce tax reached 2.63 billion yuan in 2006, while the business profit of the local SOEs was only 0.65 billion yuan.[35] In addition, the local annals indicated that the output of large private enterprises amounted to 24 per cent of all industrial production.[36] Since the 1990s, many SOEs and collective enterprises have been privatized in the Restructuring and Transformation processes, and private enterprises, individual business operators, and limited liability companies have become the driving forces of the economy. Economic activities among these organizations have proliferated, and thus they have become involved more in commercial disputes. In City S, however, privatization has not been pushed as aggressively. Indeed, SOEs may still be the major players in the local economic activities; agriculture remains the pillar industry. Although many SOEs have been restructured and privatized, they remain a major player in the local economies. In 2002, SOEs still contributed one-third of the 22 billion yuan GDP generated by large-scale enterprises.[37]

Consistent with previous findings,[38] the level of economic development will affect the type of litigants. In Court G, other than the 8 per cent of litigation parties which were SOEs, the rest were either private enterprises, collectively owned enterprises or privately owned limited liability companies. Most of the SOEs in this area were banks or credit unions, suing for unpaid loans which were protected by security. However, in Court S, 25 per cent of the litigation parties were SOEs, and most of these were not big banks or credit unions. Indeed, some of them were directly controlled by the provincial government.

My interviews indicate that with the increase in private transactions, population mobility, and marketization, the relationship among enterprises becomes simpler and more formal. Private enterprises are less hesitant to sue

35 City G Government, *Government Work Report* (2007), internal document.
36 The Editorial Committee of the Annals (eds.), *G Annal* (2006).
37 The Editorial Committee (eds.), *S Annal* (2003).
38 Woo and Wang, op. cit., n. 20.

in cases of default of payments.[39] Yet, in City S, where SOEs still play a more salient role and where the relationships among business organizations are more static, these enterprises are less inclined to sue because litigation would usually terminate the original transaction relationship. All of the interviewed litigants in Court S mentioned that, once the litigation had been initiated, they had no further business with the other party. However, in the more business-oriented environment of the Pearl River Delta, businessmen are more concerned with business opportunities than with previous litigation experience.[40]

The differences in economic development and in court users have clear implications for the adjudication and enforcement of contract litigation. Indeed, all the factors discussed later in this section are related to these core differences. The points addressed here are more straightforward. First, when the local economy is more privatized, as Whiting reports from her Nanjing study,[41] the parties in litigation are on a more equal footing. When both parties are private, the governments and the courts have less of an incentive to intervene. This contrasts with the situation when one litigation party is SOEs, since a local court certainly has little leverage against giant SOEs. As stated by one big SOE defendant in Court S: 'if we are required to pay the debt, we have to ask the central government to pay us back.'[42] Second, the more active economic activities in the affluent area have reduced the relationship costs of litigation. As noted by Friedman,[43] changes in business relationships have stimulated increases in some forms of major business litigation. When the business world comprised long-term, continuing relations, business people avoided litigation.[44] Businessmen and enterprises in the poorer area are thus more likely to bring only more intractable cases to court, especially those that have defied all alternative methods of resolution. But when 'markets have fissured, products have become more specialized, competition has increased, and business dealings are in general marked by greater instability',[45] which is the case in the richer City G, businessmen are less reluctant to sue. The new competitiveness may create an atmosphere in which short-run 'bottom-line' concerns predominate; it increases the

39 See Hendley's study on Russian entrepreneurs, K. Hendley, 'Business Litigation in the Transition: A Portrait of Debt Collection in Russia' (2004) 31 *Law & Society Rev.* 305–47.

40 See M. Galanter and J. Rogers 'The Transformation of Business Disputing? Some Preliminary Observations' (1991) Institute for Legal Studies, Working Paper DPRP 10-3; Yu and Zhang, op. cit., n. 2.

41 Whiting, op. cit., n. 4.

42 See author's interview, 2007.

43 L.M. Friedman, 'Opening the Time Capsule: A Progress Report on Studies of Courts Over Time' (1990) 24 *Law & Society Rev.* 229–40.

44 S. Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 *Am. Sociological Rev.* 55–67.

45 Galanter and Rogers, op. cit., n. 40, p. 3.

'relative stakes in individual transactions', with each becoming 'more "all or nothing".'[46] Once the business environment is so altered, as Kagan[47] finds in the American context and Hendley[48] finds in Russia, businessmen tend to bring into the courts more routine disputes with their business partners.

2. *Court finance*

Under China's court finance structure, the courts rely on local governments for their income. Therefore, court finance is closely related to whether or not the local economy has been fully developed and diversified. As shown in Table 1, the per capita financial budget of the court in Court G has been roughly 10 times higher than that of Court S. Naturally, Court S with an inadequate funding has, as a survival strategy, increased litigation fees and criminal monetary penalties.

The financial structure and actual financial situation have significant effects on both the operational pattern[49] and the enforcement capacity of the courts. The most immediate impact is the level of the litigation and the enforcement fees charged. While Court G, with adequate funding from local government, had no incentive to charge more, Court S has charged double the standard allowed by the Supreme People's Court. In addition, under the law, enforcement fees should be paid by the petitionee; in practice, however, the fees are usually advanced by the enforcement petitioner. If, ultimately, a decision cannot be enforced, the courts do not refund fees spent during the process of enforcement. Moreover, even in cases of successful enforcement, the courts still do not refund the fees advanced, even when those fees have been recovered from the petitionee. Usually, in such circumstances, the courts are let off easily since the enforcement petitioner has already achieved his or her major goal, namely, securing enforcement. This, of course, generates numerous complaints against the court.

3. *The professionalism of court staff*

The ramifications of measures to professionalize the staff depend on the region's economic development. In Court G, the increased professionalism of court staff has had a positive impact on enforcement. Judges' salaries have been increased, in part thanks to sufficient funding by local finance departments. The income of judges is much higher than the local GDP per capita. Becoming a judge has become attractive to many law graduates, who prefer a stable income and a less demanding workload than they would have

46 id., p. 6.
47 R.A. Kagan, 'The Routinization of Debt Collection: An Essay on Social Change and Conflict in the Courts' (1984) 18 *Law & Society Rev.* 323–72.
48 Hendley, op. cit., n. 39.
49 He, op. cit., n. 28.

as attorneys in a law firm. Subsequently, many courts have been able to recruit graduates and postgraduates from law schools.[50] In this way economic development has assisted the growth of a legal profession.

However, the professionalism of Court S has not substantially improved. Since the pass rate of the Uniform National Judicial Examination has been only slightly higher than 10 per cent,[51] it has been extremely difficult for discharged army officers, many of whom have received little education, to pass the exam. As a result, they tend to lack the incentive to gain entry to the courts and the proportion of legally trained graduates has risen. Given the financial constraints and limited personnel quotas, based on the population size and controlled by the local government, this Shaanxi court has only taken between one and two law graduates each year for the past five years. The percentage of court personnel with judgeship barely reaches 40 per cent, while in court G it exceeds 80 per cent. To balance the economic benefits among employees, staff without judgeship qualifications are allowed to handle cases independently. Overall, discharged army officers remain a crucial component of the judiciary, not just in number but also in the way they affect the functioning of the courts. It will not be possible to phase them out within one or even two decades. Similarly, in response to the demand for specialized knowledge so that courts operate effectively, the Party's local staffing bureau has given more weight to the recommendations of the higher-level courts when appointing local court presidents. But a more centralized system of court appointments (to break the link with local authorities), which the SPC suggested in its 1999 reform outlines, has not been implemented. Unlike his immediate predecessor, the current president has received no formal legal training. Presidents with other backgrounds have different priorities and fill their key posts with different types of staffers. In the long run, the professionalism of staff and their corresponding performance in the court may have improved as a result of the trickle-down effect, but only incrementally.

4. *The impact of adjudicative procedure reforms*

The extent to which the measures are implemented and the actual effects of these measures depend on court finances and local economic development. Court G, with sufficient financial resources, was more capable of implementing the various adjudicative procedure reforms key to better judgment enforcement. However, the situation of the court S, when struggling for financial survival, may be aggravated by such reform measures. For example, since adjudication has been separated from petition filing and

50 See M.Y. Gechlik, 'Judicial Reform in China: Lessons from Shanghai' (2006) 19 *Colum J. of Asian Law* 97–137, at 100.

51 B. Ahl, 'Advancing the Rule of Law through Education?' (2006) 42 *Issues & Studies* 171–204, at 184.

judgment enforcement, a case must be examined two or three times in the court, and this certainly involves further costs.[52] Moreover, as part of the judicial reforms, the formalization of civil procedure has had some unintended consequences that may not be conducive to judgment enforcement. Originally, when both adjudication and enforcement were conducted by a single adjudicating staffer, whether a judgment could be executed was a question the staffer must have borne in mind when adjudicating. To a certain extent, this made enforcement easier. Since the separation, however, the staffer who awards the judgment cares little about the enforcement because it is, by and large, none of his or her business. In this context, many factors that have helped to improve the enforcement situation in the more affluent area are not very useful in the less affluent one.

To make matters even worse, some of the core reform measures affecting power redistribution have not yet been implemented in the poorer area. A telling example is the establishment of a chief adjudicator. As mentioned, the division head is to be replaced with chief adjudicators in decision making, thus promoting greater judicial independence. However, this has not been implemented at all in Court S. A major reason for the discrepancy is the very low caseload in Court S – only a tenth of the caseloads of courts in the developed coastal area. The divisional directors and court presidents are therefore still able to review all the cases and keep the final decision-making power tightly in their own hands. As yet another example, the original power structure in the distribution of cases remains intact. When cases are transferred from the petition-filing division to the civil division, which is responsible for processing commercial cases, the divisional head will, in the first place, pick up whatever he or she prefers, usually the simplest cases or those with which he or she has connections. The remaining cases are assigned to ordinary judges. This contrasts with Court G, where, as the caseload become heavier, cases are randomly assigned by a computerized system with little room existing for outright manipulation.[53]

5. *Local protectionism*

Local protectionism has long been a problem in judgment enforcement in Chinese courts. It exists mainly because local governments have to rely on local enterprises, especially local SOEs, for funding. Moreover, the salaries, bonuses, benefits, and even the jobs of court staff depend on the income of local governments. Furthermore, the appointment of directors to some courts are controlled by local government and party officers.[54]

My interviews revealed a clear cleavage. At Court G, virtually no creditors interviewed mentioned local protectionism as a concern. Indeed,

52 He, op. cit., n. 33.
53 Interview, op. cit., n. 42.
54 Pei, op. cit., n. 1, p. 194; Clarke, op. cit., n. 1, p. 41.

several non-local creditors insisted that the procedures of the court were much better than what they had encountered in hinterland areas. Some interviewees specifically mentioned that the court left a very good impression on them because they faced no discrimination, despite the fact that they were non-local. This seems consistent with previous empirical studies, especially those based on large cities such as Beijing and Shanghai.[55]

One reason for such a development is that the economy in this region has become more diversified: the SOEs have lost their traditional dominance. Local government income generates more revenue from taxing the broader private sector than from SOEs and collective enterprises. A local government work report shows that the industry and commerce tax reached 2.63 billion yuan in 2006, while the business profit of the local SOEs was only 0.65 billion yuan. For similar reasons, there is little danger of social instability if SOEs are pushed into bankruptcy. Local governments thus become less dependent on SOEs and have less incentive to assist them in court.

Moreover, the financial reforms of the judiciary have given the courts less of an incentive to engage in local protectionism. Under the reformed financial policy, the courts submit all of their administrative income, including litigation fees, to local governments but have their expenses paid from a separate government budget. In the prosperous region, the local government usually provides sufficient funding. Thus, the court is not directly dependent on local enterprises, and it no longer needs to provide special protection for these enterprises in return. On the other hand, since most litigants are not large SOEs, they do not have specific resources or connections that might enable them to influence court decisions. Indeed, the court has been inundated by cases, and consequently, court procedures have been streamlined; the court has little time or energy to devote to the not-so-significant disputes of small or medium-sized enterprises.

The situation in Court S, however, is quite different. Most interviewees believe that local protectionism ran rampant there. My interviews also indicated that litigants' perceptions were largely in accord with the case results. Those who won their cases rarely mentioned local protectionism. But those non-local litigants who lost their cases readily blamed the outcome on local protectionism. Moreover, both judges and litigants agree that local protectionism consists of personal connections rather than a financial link between the local enterprises and local government. When this word was used, it could be understood – and in the literature is usually so understood – as the extra-legal interference or pressure from the local government because of its financial link to local enterprises.[56] However, it could also mean some

55 Peerenboom, op. cit., n. 3, pp. 277–8; Gechlik, op. cit., n. 50.
56 Lubman, op. cit., n. 1.

'convenience' or even benefit to a litigant because of connections between the court staff and the litigant. The judges interviewed generally regarded the former as rare but the latter as common. It remains, after all, a close-knit community where it is not difficult to find acquaintances at the court. While discounting the seriousness of local protectionism in routine cases, the judges never denied the existence of almost unavoidable undue influence in cases directly involving the local government.

6. *The litigants' views of the courts*

Consistent with a broader survey which has suggested that the situation in rural China is worse than it is in urban regions,[57] my interviews with litigants suggests that their impression of Court G was more positive. Many litigants of Court G said that the judges were patient and clear in explaining court procedure. Sixty-three of the plaintiffs held a positive view of the court's performance at the adjudication phase, but the corresponding figure in Court S was only 48 per cent. Only 12 per cent of the plaintiffs in Court G had a negative view of the court's performance in the enforcement phase, but in Court S, the figure was as high as 50 per cent. A high proportion of the litigants in Court S complained about the quality of the judges, including their manner of treating litigants.

Table 2. The results of debt-collection enforcement in Courts G and S

Research Site	No. of Cases/ Litigants	Fully Recovered	Partially Recovered	Nothing Recovered	Plaintiffs Holding Negative Impression of Enforcement
Court G	66	53%	23%	24%	12%
Court S	60	45%	33%	22%	50%

Source: The author's fieldwork investigation.

My interviews also find that the plaintiffs' impression of the court G has become more positive after they had gone through the courts. In particular, most plaintiffs (42) were highly satisfied with the adjudication process. Among eleven interviewees who did not comment, some had not been present during the adjudicating process (their lawyer was) and some reached an agreement with the other party immediately after filing the petition. Some did not want to comment. Many interviewees said that the judges had explained the court procedure clearly and patiently. These improved impres-

57 Michelson and Read, op. cit., n. 8.

sions are clearly due to, among other factors, the increased professionalism of court staff.

In contrast, the impression of plaintiffs of Court S is less favourable. The interview results were significantly worse than they were in the more developed regions. A high proportion of litigants complained about the quality of the judges' manner in dealing with the litigants, while in the more developed regions, a majority of litigants noted, to their surprise, that they had been impressed by the working style and professionalism of the staff.

My data and especially the interviews with the litigants indicate two major reasons for these relatively poor impressions. One reason is the enforcement result. Interviews with the litigants found a strong correlation between the enforcement result and the impression of the court: the impression would be positive when the court helped them to recover the debt, especially when it was fully recovered. Otherwise, the impression was negative. This was consistent with the data on the reason for litigation. All but two plaintiffs said that the only purpose of litigation was to get their money back, and most used the court only as their last-ditch effort in a very long process of debt collection. As a result, when the court helped them, they were grateful. But when the court failed to do so, they were less generous. One plaintiff said:

> We could not recover our debt by ourselves, that's why we resorted to the court. But if the court could not even get its own judgment enforced, how could we have a good impression? We did not have issues with the adjudicating judge, but were sceptical about the court's efforts in enforcement.[58]

The other major cause of the relatively poor impression made by the courts was the extra fees they charged. As noted earlier, the fee scales of the courts were formerly much higher than the SPC guidelines. In one settled case with only 865 yuan at issue, it was stated: 'Fifty yuan is payable in litigation fees and 300 yuan in other litigation fees; the plaintiff shall be responsible for 150, the defendant for 200.' The 'other litigation fee' in this case was six times the normal litigation fee and the two together represented 40 per cent of the amount at issue. In many medium-sized cases, the interviewees informed us that the rate was 8 per cent of the amount. Should the plaintiffs initiate the compulsory enforcement process, they had to pre-pay the enforcement fees. It was declared that pre-paid fees would be returned after the cases had been enforced, but according to the interviewed judges, the courts had never made any effort to fulfil their promises until the 2007 guideline of the State Council put a stop to such declarations.

Many of the plaintiffs of Court S interviewed complained about these extra fees, as they were not charged in a neighbourhood basic-level court. Some litigants directly referred to this obvious discrepancy. They were

58 Interview, op. cit., n. 42.

extremely dissatisfied in two respects. The first was that after they had paid all the required litigation fees and even pre-paid the enforcement fees, nothing was recovered, including none of these fees paid to the court. The second source of dissatisfaction was when the cases were withdrawn immediately after they had been filed. The plaintiff then believed that the court had done nothing to earn the fees charged. This kind of overcharging has certainly reinforced an already negative impression among litigants.

7. *Enforcement results*

As the cases were chosen randomly, there is no way of knowing whether or not the small number in the data set was representative. Because of local protectionism, some cases may not even make it to court: the courts may refuse to hear cases that involve local state-owned enterprises. As a result, there is a risk of reading too much into the numbers. In both studies, as shown in Table 2, more than 45 per cent of plaintiffs received the entire amount they were owed and roughly three-quarters received part of it. In line with Whiting's findings,[59] a high percentage of cases were closed either by mediation or withdrawal, which usually means that the debts were fully paid. The high rate of capitulation by defendants is consistent with the notion that there were no contested legal issues.[60] In the case of mediation, the efforts of the adjudicating judges were key to a settlement. Case withdrawal occurred largely because debts were paid as soon as the debtors were notified by the courts that their cases had been brought into the judicial process. Moreover, the real amount recovered by the courts' enforcement activities was not insignificant: more than 50 per cent of plaintiffs did not leave the court empty-handed.

Nevertheless, there is a discrepancy between courts in the richer and poorer areas. While in Court G more than 53 per cent of the plaintiffs recovered the entire amount owed, in Court S, the corresponding figure was only 45 per cent. The 9 per cent difference is negligible, given the fact that routine cases dominated the dataset.[61] With regard to another key measurement of enforcement capability – the extent to which cases that enter into the enforcement stages are actually enforced – there is also a discrepancy: 57 per cent of the creditors in Court G recovered something but, in Court S, the figure was only 50 per cent. Furthermore, the discrepancy becomes more obvious if one looks at the cases that were not enforced at all. In Court G, of the 16 cases that were completely not enforced, nine were

59 Whiting, op. cit., n. 4.

60 Kagan, op. cit., n. 47.

61 It is believed that, unlike politically sensitive cases, courts in authoritarian states handle routine cases efficiently and effectively. See R. Sharlet, 'Stalinism and Soviet Legal Culture' in *Stalinism: Essays in Historical Interpretation*, ed. R.C. Tucker (1977) 155–79.

because the debtors had no enforceable assets, four were because the courts and the creditors could not locate the debtors, and three were because the debtors had transferred or hoarded property. For the nine cases in which the debtors did not have enforceable assets, (56 per cent of the total), the court could not be blamed. As Peerenboom says in his research on the enforcement of arbitrational awards, it is impossible to squeeze blood from a stone.[62] It does not mean that in these cases the courts have exhausted civil procedures to push the debtors into bankruptcy. When no properties are located with routine efforts, however, the court has to think about whether further actions are worth the cost. But in Court S, of the 13 cases in which the plaintiff left empty-handed, only four (less than 31 per cent) were due to the lack of enforceable assets. More importantly, three were because of complications left from the planned period, a category that is not seen in Court G. Further, another three were a result of 'triangle debts' situation: one would not pay until the others in the triangle paid first. This indicates that it is easier to find the legacy of the socialist period in City S, which hinders the contract enforcement. In other words, the economic reform in City S may not be as thorough as in City G, and the court, a relatively weak player in local political context, has few means to collect debts owed by SOEs.

ECONOMIC DEVELOPMENT AND CONTRACT ENFORCEMENT: A THEORETICAL INQUIRY

To what extent do these data and analysis shed light on the two hypotheses on the relationship between China's formal contract enforcement and economic development mentioned at the beginning of the article? Does market demand lead to better enforcement or is the improved legal system conducive to economic development?

1. *Is formal contract enforcement indispensable for economic development?*

This link is difficult to establish. The above empirical evidence suggests that the economy will develop with or without healthy formal contract enforcement. One or two decades ago, before the economy of City G had taken off, the quality of formal legal institutions was not as good as it is today. However, that did not prevent the economy of the richer area from flourishing. Many alternative mechanisms have helped to enforce contracts. Some social norms shared by business circled and informal private enforcers are still in effect, although their functions may be limited.[63]

62 Peerenboom, op. cit., n. 3, p. 270.

63 J. Landa, 'A Theory of the Ethnically Homogeneous Middleman Group: An Institutional Alternative to Contract Law' (1988) 10 *J. of Legal Studies* 349–62; L. Lim and P. Gosling, 'Strengths and Weakness of Minority Status for South Asian

It seems that when deals become bigger and disputes are significant and complicated, the administrative branches assume crucial roles in dispute resolution, including contract enforcement. In these situations, the courts' roles are only supplementary. They are usually asked to participate in and streamline the process – for instance, to facilitate the arbitration process relating to mass workers' compensation or to freeze the immovable property of runaway enterprises whose investors have disappeared.[64] The court system is only one of many alternative mechanisms for enforcing contracts. In other words, like labour and other socio-economic disputes, difficult contract disputes cannot be handled by conventional litigation.[65] When a mechanism becomes less effective or more expensive, other mechanisms will become more desirable.

Contracts thus do not necessarily have to be enforced by a court when the economy has or has not developed beyond a certain level. Of course, the literature does not explain what 'a certain level' is. However, when the courts become more desirable and important, potential litigants are less likely to use alternative means of dispute resolution. In this sense, better formal contract enforcement provides business operators with a cheaper alternative, thus reducing the transaction cost of the local economy and contributing to economic development. Yet, this change does not in any sense suggest that contracts cannot be enforced without formal courts. Nor does it mean that an investment in better courts is worth it. Only a cost-benefit analysis will ascertain whether better courts will bring down dispute costs enough to justify the investment.

The limited role of the courts can be seen more generally in foreign investment, one of the most important engines of China's economic development and one that is closely related to long-term formal contract enforcement. When investors make their investment decisions, the enforcement capability of the courts is only a tiny consideration among many far more important ones.[66] Indeed, when investment started pouring into the Pearl River Delta in the late 1980s, the quality of the legal institutions was very poor. In addition, foreign investors invested in the regions largely because of the state's preferential policy, the good infrastructure in the area, and the convenient transport system. Since the central government's campaign to open up the

Chinese at a Time of Economic Growth and Liberalization' in *The Essential Outsiders*, eds. D. Chirot and A. Reid (1997) 285–311; L. Bernstein, 'Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry' (1992) 21 *J. of Legal Studies* 115–57.

64 Y. Su and X. He, 'Street as Courtroom: State Accommodation of Labor Protests in South China' (2010) 44 *Law & Society Rev.* 157–84.

65 R. Peerenboom, 'More Law, Less Courts: Legalized Governance, Judicialization, and Dejudicialization in China' in *Administrative Law and Governance in Asia*, eds. T. Ginsburg and A. Chen (2009) 175–202.

66 R. Peerenboom, *China's Long March toward Rule of Law* (2002) 466.

west, there has been an increase in investment in rural and hinterland China,[67] despite the generally poor quality of the legal institutions in this area.

2. *Does a developed economy demand better formal enforcement?*

This proposition has been partially vindicated. As seen in both courts, court users are generally private-owned enterprises and the docket is full of routine debt-collection cases. These changes have made it possible for the courts to handle cases in a more neutral way. Although the political status of the courts remains weak in relation to other dominant political powers, these changes make direct and blunt intervention less necessary.

Increased caseloads, arguably one of the consequences of economic development or economic reforms, also create demands for changes in the institution building which are indispensable for better contract enforcement. During the reform period, caseloads in the commercial area have increased, with an expansion in the range of justiciable disputes, while mediation has decreased and arbitration has remained relatively stable and limited.[68] Increased caseloads have certainly compelled the court system and the enforcement mechanism to reform. In Court G, reforms, including those to the case management system, the rules of evidence, and the time limits for the completion of cases and various stages of the litigation process, have tried to increase the efficiency and fairness of the process.[69] The court has also streamlined both its adjudication and enforcement procedures and has tried to professionalize its staff, who, under the reformed procedures, are more capable of handling disputes. At the same time, the reformed formal contract enforcement has exposed the weaknesses of the informal mechanisms for enforcing contracts, thereby increasing reliance on the formal legal system and correspondingly increasing the demands for change.[70] Without such an increase in caseloads, as suggested by the situation of Court S, many reform measures have yet to be implemented.

3. *Is economic development sufficient for better formal enforcement?*

The efforts in institution building and increasing staff professionalism in the richer areas could be regarded as a response to the demand for better contract enforcement. Yet, such efforts have not been limited to these parts of China.

67 D.S.G. Goodman, 'The Campaign to "Open up the West": National, Provincial-level and Local Perspectives' (2004) 178 *The China Q.* 317–34; E.B. Vermeer, 'Shaanxi: Building a Future on State Support' (2004) 178 *The China Q.* 400–25; C.A. McNally, 'Sichuan: Driving Capitalist Development Westward' (2004) 178 *The China Q.* 426–47.

68 Zhu, op. cit., n. 21, pp. 21, 26.

69 Supreme People's Court Drafting Group, 'Reform of the People's Court: A Review and Future Prospects' (2007).

70 Peerenboom, op. cit., n. 66, p. 468.

Court S, for example, has undergone similar institutional reforms. However, in this area, there is no developed economy acting as a cause for reform; the same judicial reforms occur anyway, despite the poor economic development in this area. More importantly, these judicial reforms occur even though the reform measures may have aggravated the courts' institutional capacity. Therefore, the better contract enforcement found in City G must be due to reasons beyond its economic development. In other words, economic factors are not the sole reason for the better formal contract enforcement found there. This section argues that a combination of both economic and non-economic factors is responsible for these better enforcement results.

Indeed, China's judicial reforms, including institutionalization and staff professionalism, cannot be isolated from their background. When the Supreme People's Court promulgated two Five-year Reform Outlines in 1999 and 2005, the State Council issued two directives: 'The Decision to Comprehensively Further Administration in Accordance with Law' in 1999 and 'Implementing Outlines to Comprehensively Further Administration in Accordance with Law' in 2004.[71] When the courts made efforts to streamline their procedures, the directives of the State Council required the establishment of clear and transparent administrative procedures. When the courts raised the threshold for recruiting entry-level judges under the National Uniform Judicial Exam, the government introduced the uniform entrance examination for civil servants. In other words, even though there are some unique aspects of the judicial reforms because of the specialized function of the judiciary, reforms similar to the institutionalization and professionalism of the courts have been implemented throughout the government.

Moreover, although China's judiciary has incorporated some elements of Western judiciaries, the reforms in the judiciary have followed the bureaucratic model of rationalization. Indeed, many of the judicial reform measures are consistent with those inside the government; for example, judges are treated as civil servants in respect of their selection, promotion, and supervision. The courts' efforts to improve efficiency and to separate the different sections of the adjudication process are also in line with the government's efforts relating to transparency and efficiency.[72] Even the new scale of litigation fees has to be stipulated by the administrative branch.[73]

It is hard to believe that all of these similarities are merely coincidental. Although the judiciary is not an administrative branch of the government, it performs essential administrative functions and it is a very important administrative component of the social control mechanisms of the ruling party. Indeed, one can easily see the inherent link between the judicial

71 State Council, 'The Outlines of Administration in Accordance with Law' (1999); State Council, 'Implementing Outlines to Comprehensively Further Administration in Accordance with Law' (2005).

72 SPC, op. cit., n. 22; State Council, id.

73 State Council, *The Measures on Litigation*, Fees Taking (2006).

reforms and the administrative reforms in this context: both sets of nationwide reforms have been launched by the ruling party. As these reforms are not imposed by alien powers, more likely than not they are intended to fulfil some necessary and important social and political functions. The development of the judiciary is thus located in the context of a historical state-building process.[74]

In fact, the institutional and professional developments, along with the more general policy of 'administration in accordance with law,' can arguably be regarded as a response to the ruling party's need to govern society in a changed socio-economic environment. In the late 1990s, China experienced widening income gaps, mounting social conflicts between the haves and the have-nots, and deepening confluences between officialdom and business. Economic reforms have unleashed a variety of social forces and conflicts that cannot be contained within a traditional state structure.[75] After the economic reforms, the state lost its grip on people's economic behaviour. With the retreat of the state, it has less effective control over society.[76] All these factors seem to have been the most likely midwife to the birth of 'administration in accordance with law'; this method of governing is believed to be more capable of dealing with these forces and ruling the country.[77] That is why these reforms were launched in rural and hinterland area where such reforms, by disrupting the old order without replacing it with a new one, may simply cause more problems than they solve.[78] Only in this context can one understand all these unusual or unnecessary reform measures implemented in rural areas. Thus, judicial reforms are one of many efforts made by the state to resolve disputes in the reform era when the ruling party 'crosses the river by touching the stones'. In this sense, judicial reforms are simply a not-so-important part of the huge wave of juridification, or 'administration in accordance with law,' as defined in the State Council's reform outlines.[79]

74 K. Jayasuriya, 'Introduction: A Framework for the Analysis of Legal Institutions in East Asia' in *Law, Capitalism and Power in Asia: The Rule of Law and Legal Institutions*, ed. K. Jayasuriya (1999) 1–27

75 X. Ding, 'Institutional Amphibiousness and the Transition from Communism: The Case of China' (1994) 24 *Brit. J. of Political Sci.* 293–368.

76 V. Shue, *The Reach of the State: Sketches of Chinese Body Politics* (1988).

77 X. He, 'Administrative Law as a Political Control Mechanism in Contemporary China' in *Building Constitutionalism in China*, eds. S. Balme and M. Dowdle (2009) 143–61.

78 S. Zhu, *Songfa Xiaxiang* [Sending Law to the Countryside] (2000).

79 One may argue that judicial reforms across the nation are still driven by the economic development of the richer areas. For instance, it could be that economic factors produce a demand for court reforms in economically richer area and, for constitutional reasons, any reforms must be carried out on a nationwide basis. This is because, constitutionally, China does not have a federal system which allows judicial reforms to be implemented only in the richer area and not in the poorer area. Yet, even if this argument makes sense, it only suggests that it is the economic

After the position of the central government is discerned, the dynamics between local governments and the development of court capacity become more understandable. When the policies of judicial reforms and 'administration according to law' are implemented at the grassroots level, the reform efforts toward institution building and professional development in the courts have a better chance of being realized in the richer area because local governments and the regions in this area are generally richer. The adequate financial resources in the developed regions make their courts more effective. Thus, the strengthening of formal contract enforcement depends on the available resources of given localities.

This point can be seen in the attitude and behaviour of the local governments in both areas toward building a better court system to develop the local economy. The major political forces at the local level across the country are, of course, willing to provide a better business environment. This does not mean, however, that they have tried their best to develop the courts institutionally and professionally. These political forces may not object to the establishment of well-functioning courts, and they may even support them. However, the development of such courts is by no means their top priority. If good formal courts were the key to economic growth, the Shaanxi government would spend money on them. Indeed, politically important officials are rarely appointed court directors, and major political forces have been the determining factor in the decision making of the courts. In most circumstances, a better business environment does not mean a more institutionalized court or stricter legal enforcement. Rather, it always means more evasion of national laws and more personal promises and preferential treatment offered by major political leaders in the region to potential investors. In foreign direct investment (FDI), for example, '"stability and continuation of economic policies" and "local preferential policies" originally designed for some regions' are crucial to attracting and maintaining FDI inflows, while the build-up of a healthy legal system, together with a transparent administration, have still disappointed investors.[80] Some empirical studies have suggested that the most important tactics to attract foreign investment have invariably excluded, or compensated for, a sound legal system.[81] Local governments often circumvent regulations at the

development in the richer area, rather than the poorer area themselves, that drives judicial reforms in the poorer area, or that economic forces lead to judicial reforms in the poorer area only in a remote or indirect way. See State Council, op. cit. (1999, 2005), n. 71.

80 L.F.Y. Ng and C. Tuan, 'FDI Promotion Policy in China: Governance and Effectiveness' (2001) 24 *World Economy* 1051–74, at 1072; L.F.Y. Ng and C. Tuan, 'Building a Favourable Investment Environment: Evidence for the Facilitation of FDI in China' (2002) 25 *World Economy* 1095–114.

81 H. Wang, 'Informal Institutions and Foreign Investment in China' (2000) 13 *Pacific Rev.* 525–56; A. Hampton, 'Local Government and Investment Promotion in China' (2008) working paper for Institute of Development Studies, at <www2.ids.ac.uk/gdr/cfs/pdfs/AndreaHamptonFDI-WPDec06final%20.pdf>.

central level. Ambiguous or murky property rights provide regional officials with tremendous leeway in managing FDI.[82] On the one hand, the lack of a healthy legal system has not really deterred investment. On the other hand, when major and significant incidents occur, the courts are often required to toe the political line.[83] In this sense, the institutional development of the local courts comes less from the market demand of the developed economy in urban areas and more from the uniform judicial reform occurring across the country. In other words, national judicial reform is taking place more for political than economic reasons, and the courts in the developed regions, and very likely only those, have become more effective for both political and economic reasons.

Therefore, while Court G has indeed become more effective, this change has occurred because the local governments in this area, with more developed local economies, have more income and can consequently afford to give more financial support to the court. As shown in the experience of the poorer area, without financial support, the reform measures alone struggle to produce positive results. So, when the central government launches nation-wide judicial reforms, local governments are capable of implementing them in a more meaningful way. In other words, the development of the local economy or, more accurately, of local financial resources, provides the precondition for institution building and staff professionalism in the courts. The diversified economies in this area, which mean more court users with more or less the same legal status, provide the conditions, from the demand side, for the courts to handle disputes in a more neutral way. However, other 'demand' forces are not directly related to the economy. A richer population, for example, is more likely to be better educated and may demand fairer judicial procedures. History, size, and even proximity of the jurisdictions may also matter. Developed economies are thus necessary rather than sufficient conditions: when an economy develops, the performance of the court does not necessarily improve.

CONCLUSIONS AND IMPLICATIONS

Through a detailed empirical examination of the mechanism by which economic development, courts, and politics interact, the argument that economic development is an important factor in generating demand for mature contract enforcement has more empirical support. In particular, the older state-actors in the form of the SOEs are frustrating reform because of their entrenched interests, but a developed and diversified local economy changes the demand side of formal contract enforcement, making it possible

82 Y. Huang, *FDI in China: An Asian Perspective* (1998) 31–41.
83 Su and He, op. cit., n. 64.

for it to be conducted in a more neutral and effective way. The best treatment for China's ailing legal system therefore seems to be economic development. But my analysis suggests that the reverse causal link does not capture the full extent of the relationship between economic development and formal contract enforcement. Though in the richer area G, China's court system and formal contract enforcement have become more mature and economic factors are important, this situation has come about largely due to a combination of adequate financial resources and political concerns to govern the country under a changed socio-economic environment. It reminds us that politics remains an important element in the process of legal reforms in a developing country.[84]

This analysis also compels us to revisit an old debate. For a time, scholars have debated whether or not China can sustain its development without a healthy and formal legal system.[85] However, this debate may be taking a direction different from the trajectory of China's legal development. If, as suggested in this study, China's legal institutions may develop along with the more developed economy, then what we should pay attention to are the interactions and dynamics among law, legal institutions, politics, and economic development in their context. If formal contract enforcement is not crucial in economic development, it would be interesting to see if the dynamics between formal contract enforcement and economic development exist in other key areas of the law and legal institutions, such as property rights and corporate governance.[86]

84 See Jayasuriya, op. cit., n. 74; Y. Dezalay and B.G. Garth, *The Internationalization of Palace Wars* (2002); A. Perry, 'The Relationship between Legal Systems and Economic Development: Integrating Economic and Cultural Approaches (2002) 29 *J. of Law and Society* 282.

85 C. Jones, 'Capitalism, Globalism, and the Rule of Law: An Alternative Trajectory of Legal Change in China' (1994) 3 *Social & Legal Studies* 195–221; J.K. Winn, 'Relational Practices and the Marginalization of Law: Informal Financial Practices of Small Businesses in Taiwan' (1994) 28 *Law & Society Rev.* 193–232; Dam, op. cit., n. 17; R. Peerenboom, *China Modernizes: Threat to the West or Model for the Rest?* (2007).

86 D.C. Clarke 'Economic Development and the Rights Hypothesis: The China Problem' (2003) 51 *Am. J. of Comparative Law* 89–111; D. Acemoglu and S. Johnson, 'Unbundling Institutions' (2005) 113 *J. of Political Economy* 949–95; F. Upham, 'From Demsetz to Deng: Speculations on the Implications of Chinese Growth for Law and Development Theory' (2009) 41 *NYU J. of Law & Politics* 551–602.