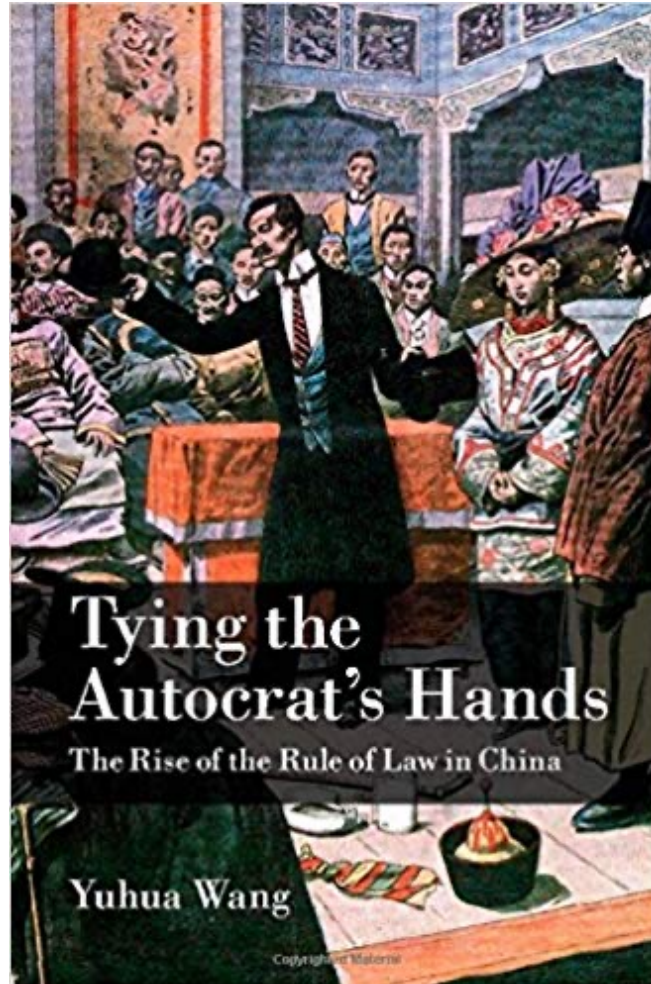


Tying the Autocrat's Hands

The Rise of the Rule of Law in China

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Panacea for All the World's Troubles

How can US policy on China cut through the conundrum of balancing human rights against economic interests? Promoting *the rule of law*, some observers argue, advances both principles and benefits. What will it take for Russia to move beyond Wild West capitalism to more orderly market economics? Developing *the rule of law*, many insist, is the key. How can Mexico negotiate its treacherous economic, political, and social transitions? Inside and outside Mexico, many answer: establish once and for all *the rule of law*. Indeed, whether it is Bosnia, Rwanda, Haiti, or elsewhere, the cure is the *rule of law*, of course.

Thomas Carothers

Vice president for studies at
Carnegie Endowment for International Peace

Why some nations have the rule of law, while others do not?

Rule of Law is not easy...

I, as your duly-elected President of the Republic, use this power implemented by military authorities to protect the Republic of the Philippines and our democracy... the judiciary shall continue to function in accordance with its organization and personnel...

Ferdinand Marco

President of Philippines, 1965-1986

Prime Minister Hun Sen of the ruling Cambodian People's Party (CPP) delivered a televised statement in support of the dissolution stating that it was based on the principle of the "rule of law", and that Cambodia was enforcing its "own law"...

Hun Sen

Prime Minister of Cambodia, 1985-?

Rule of Law is not easy...

If there are people who act outside the law, then the state must use legal means to impose law in the interests of majority. That's the way it's done in the U.S., and that's the way it's done in Russia.

Vladimir Putin

President of Russia, 2000-2008, 2012-?

Our efforts to build a country, government, and society based on the rule of law have been mutually reinforcing; the system of distinctively Chinese socialist rule of law has been steadily improved; and public awareness of the rule of law has risen markedly.

Xi Jinping

President of China, 2012-?

Rule of Law versus Democracy

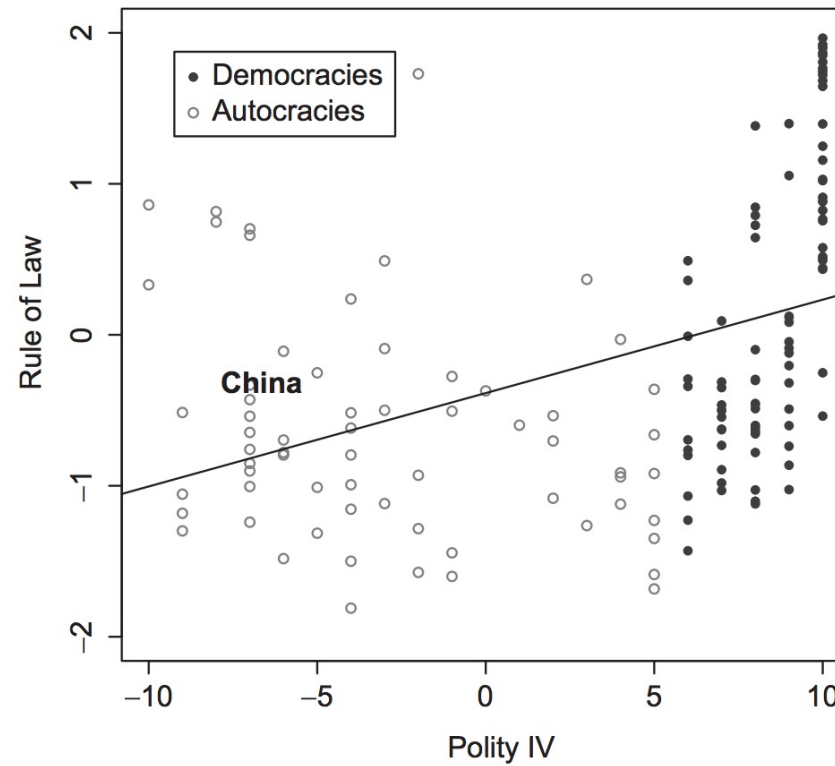


FIGURE 1.1 The Rule of Law versus Democracy (2008)

Sources: Kaufmann, Kraay, and Mastruzzi (2009) and Marshall and Jaggers (2009).

The Question

Under what conditions would authoritarian rulers promote the rule of law?
What type of rule of law exists in authoritarian regimes?

A Demand-Side Theory

Authoritarian rulers will respect the rule of law when they need the cooperation of *organized interest groups* that control *valuable and mobile assets* but are *not politically connected*.

A Demand-Side Theory (cont'd)

- Authoritarian rulers cannot solely rely on force to stay in power, they need the cooperation of interest groups who control valuable assets.
- Interest groups compete for political connection to gain privilege.
- Interest groups with political connections seek to maintain their privileges, whereas those who are not politically connected will seek the rule of law.
- Authoritarian rulers are more likely to respect the rule of law when they need the cooperation of interest groups that control valuable assets but are not politically connected.

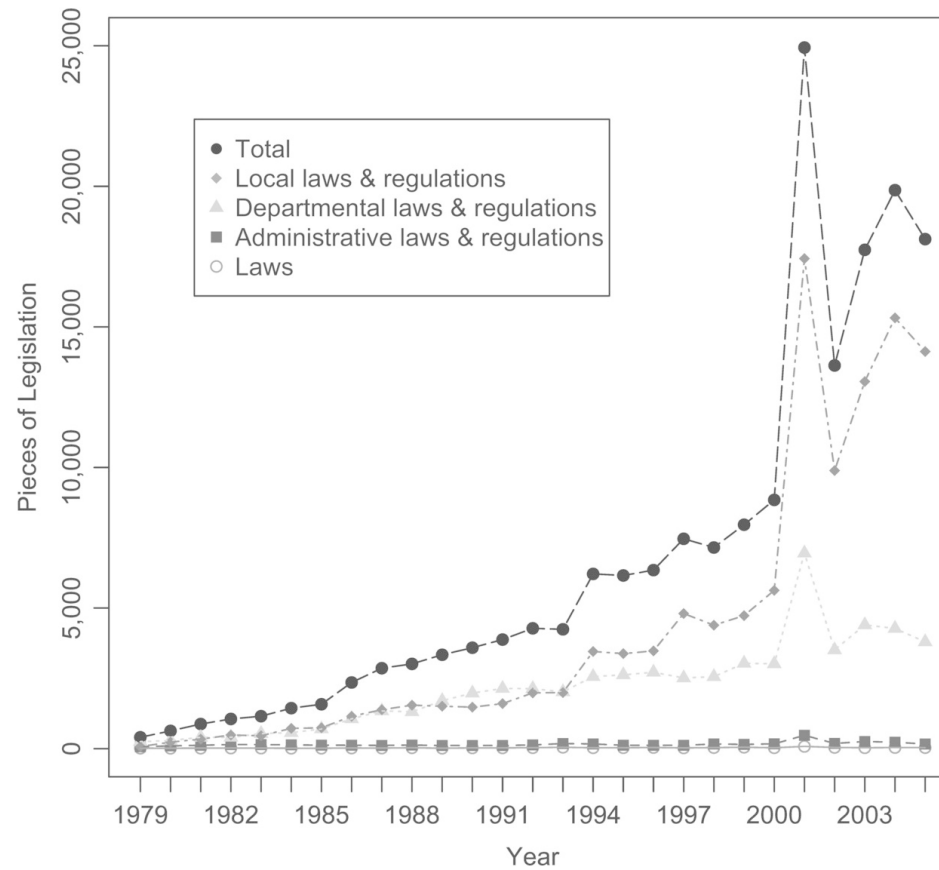
Partial Rule of Law

- Dilemma
 - Must respect rule of law to make credible commitments to investors
 - A strong judiciary might open channels for activists to challenge the state
- Resolve: partial form of the rule of law
 - Judicial fairness is respected in the economic realm
 - Remain discretionary power in the political realm

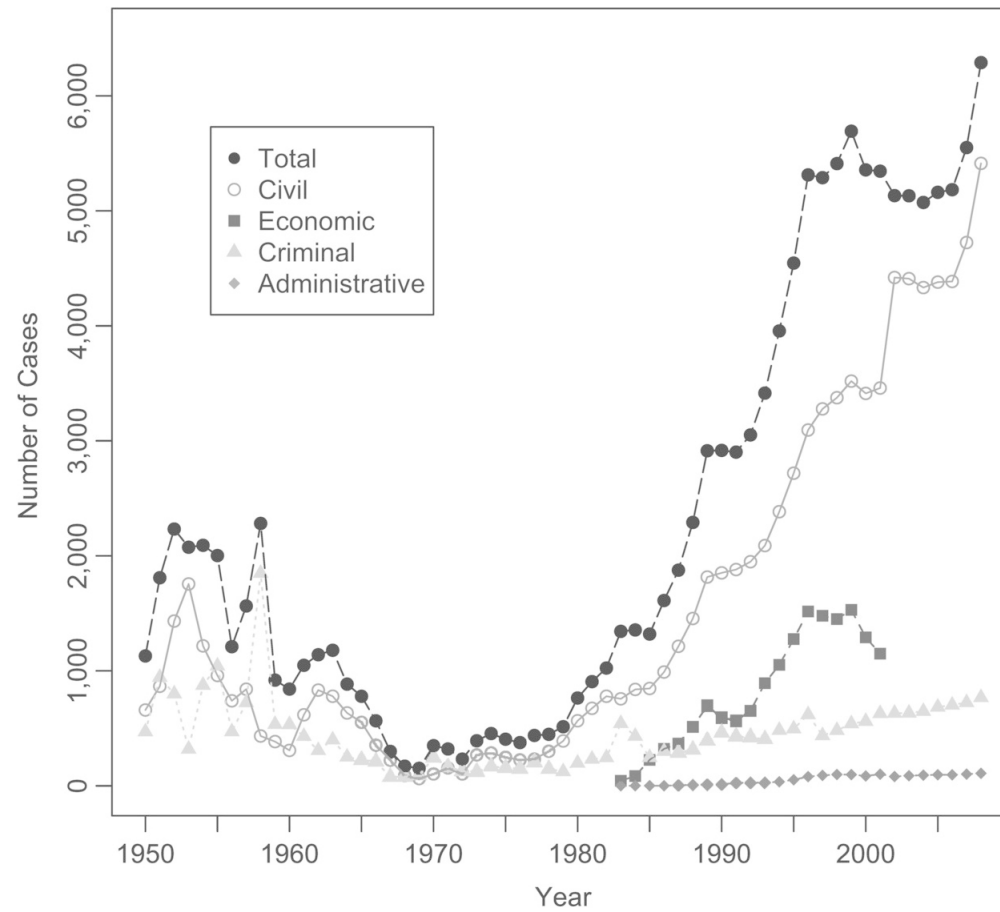
Empirical Study of Contemporary China

- One of the most durable authoritarian regimes
- In transition from rule-of-man to rule-of-law
- Foreign investors with important assets but not politically connected
- Offers considerable heterogeneity across regions

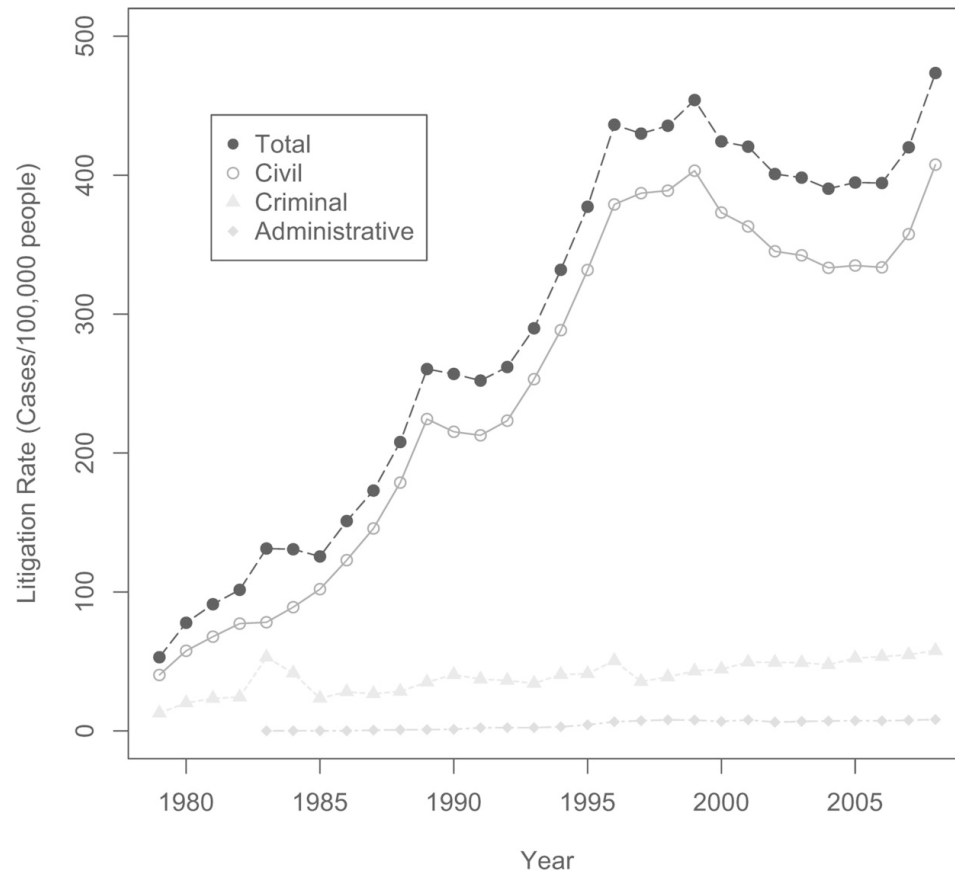
Backgrounds: China's Judicial System



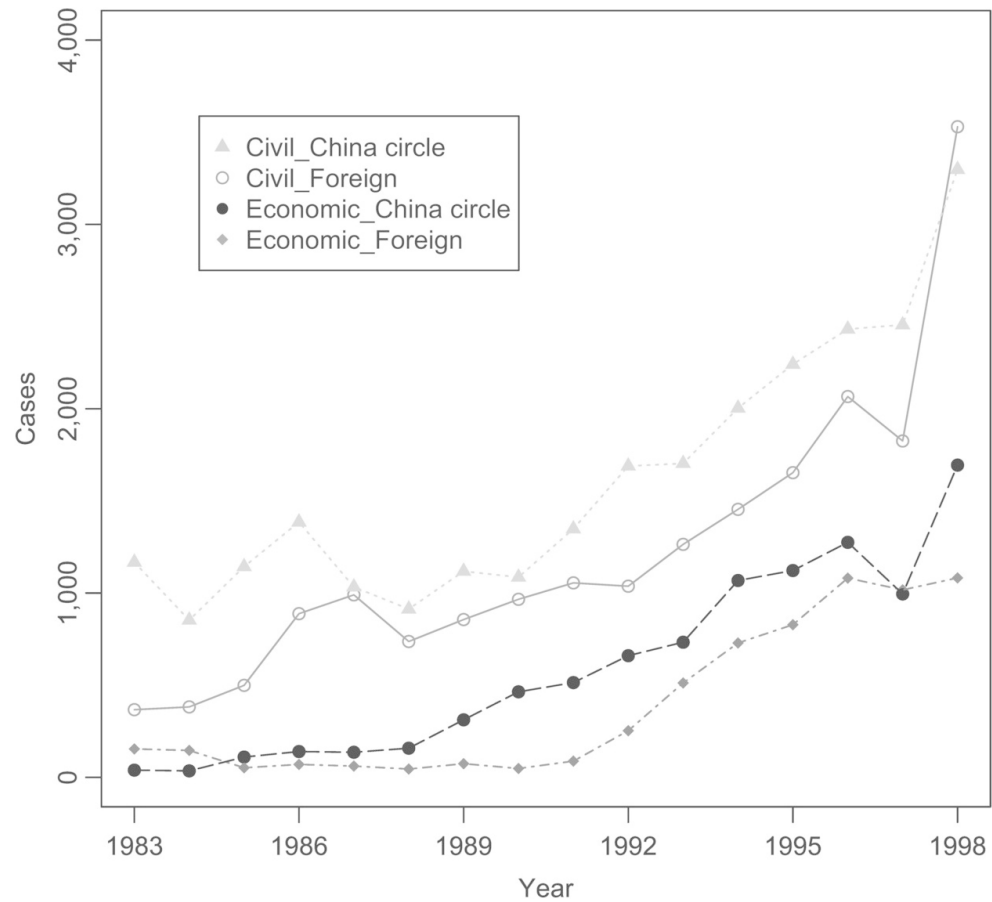
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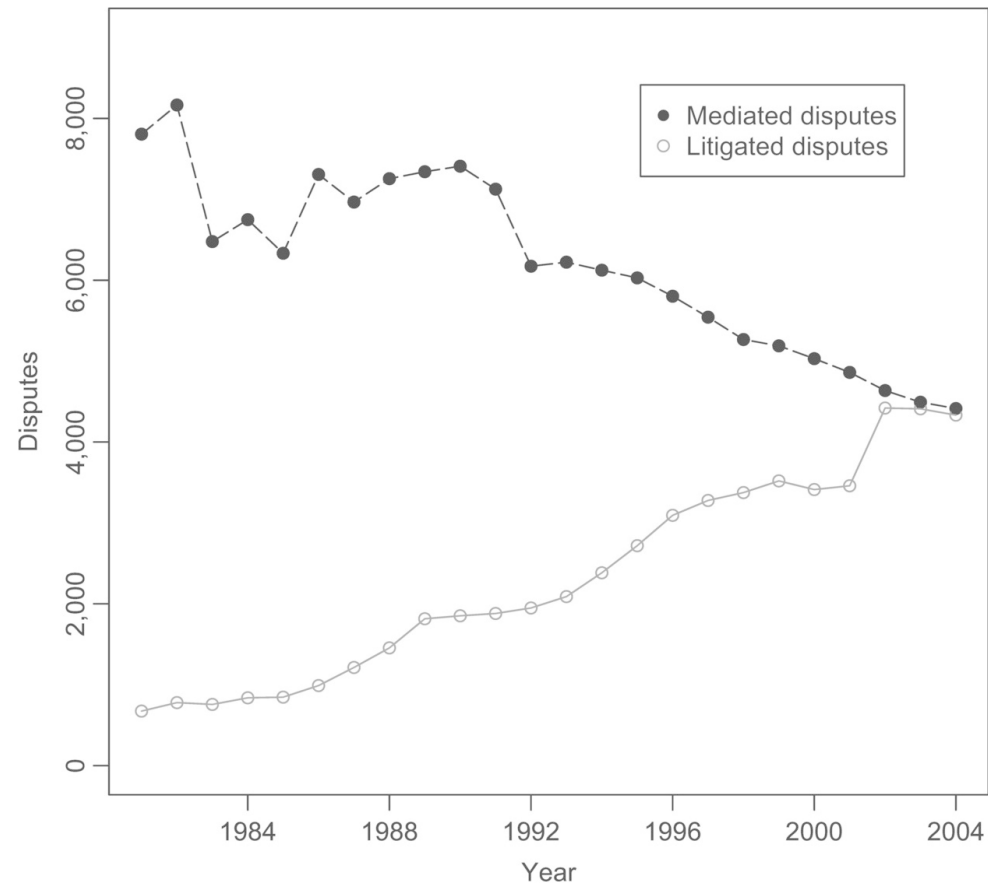
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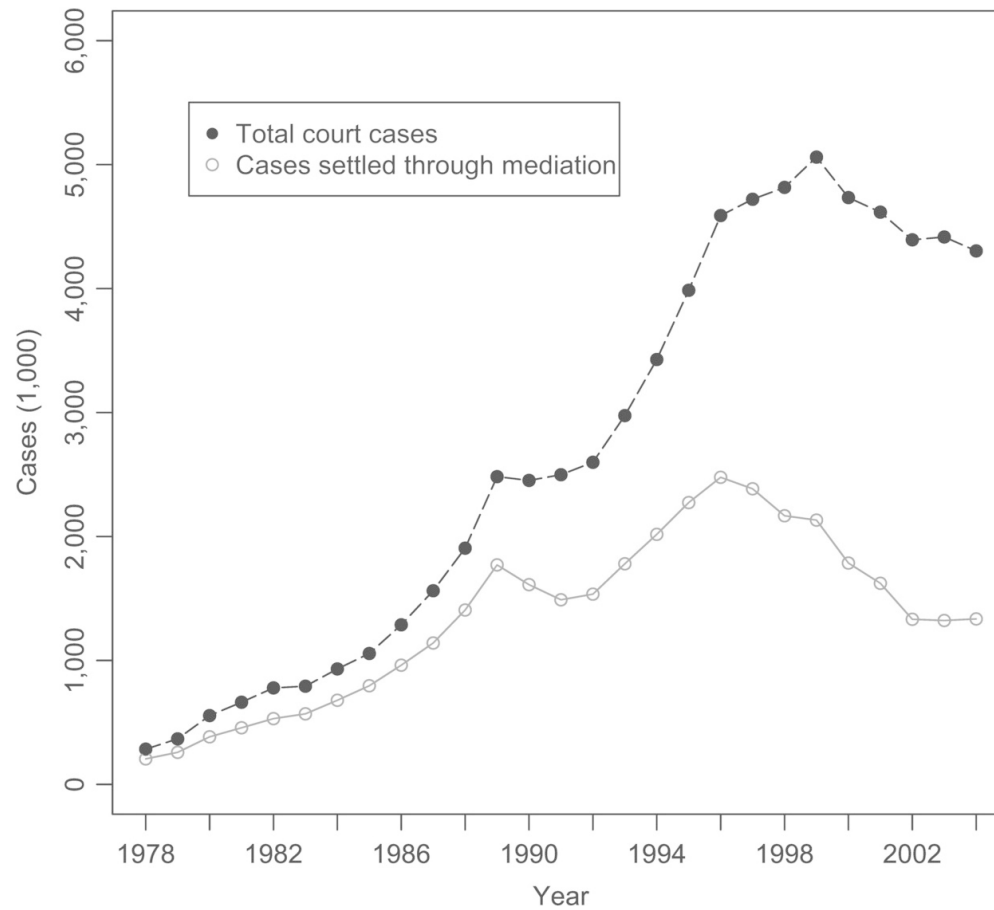
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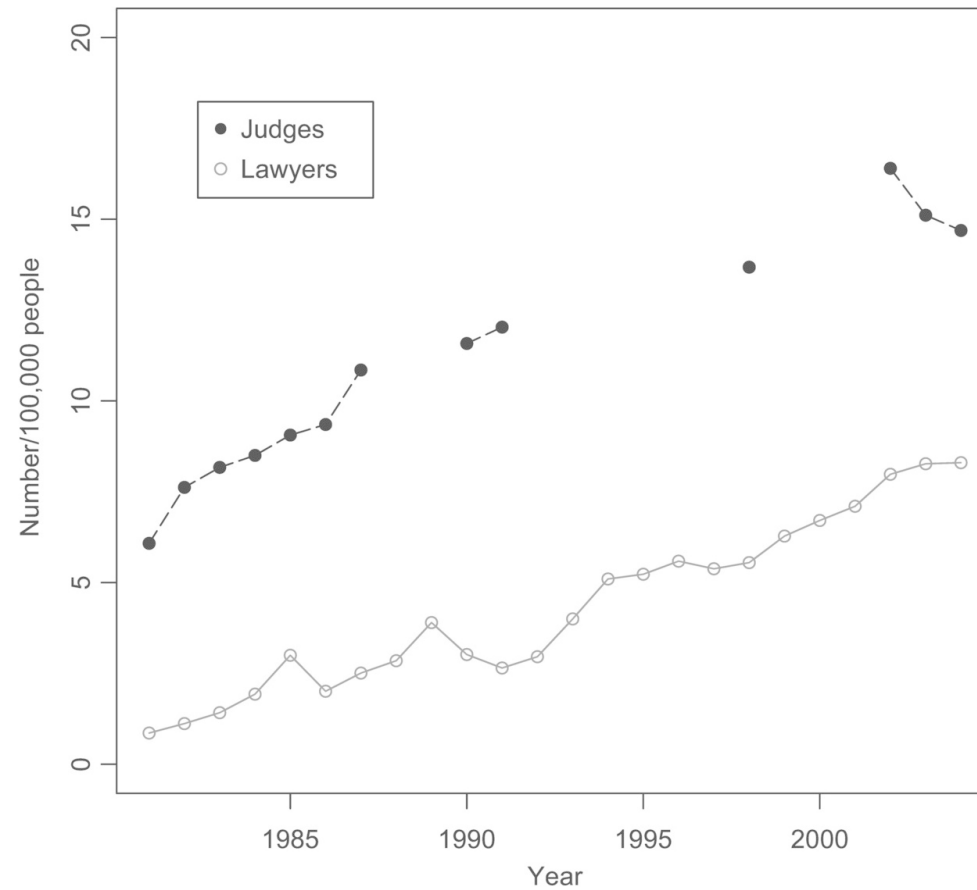
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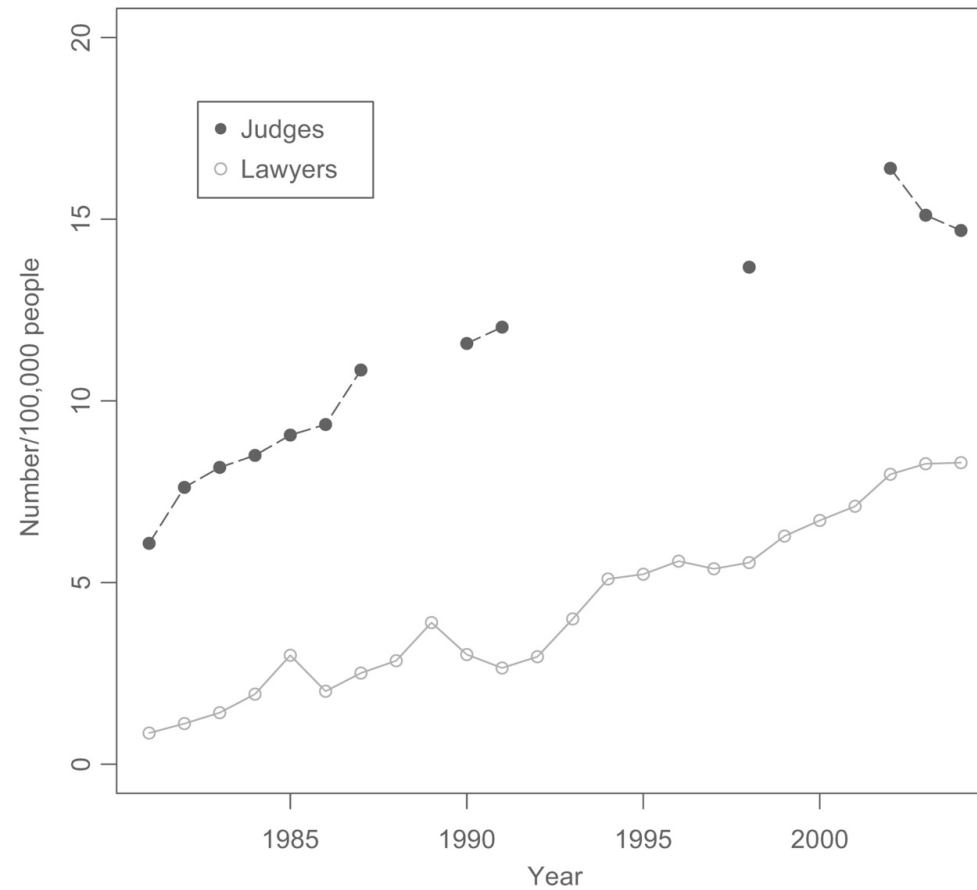
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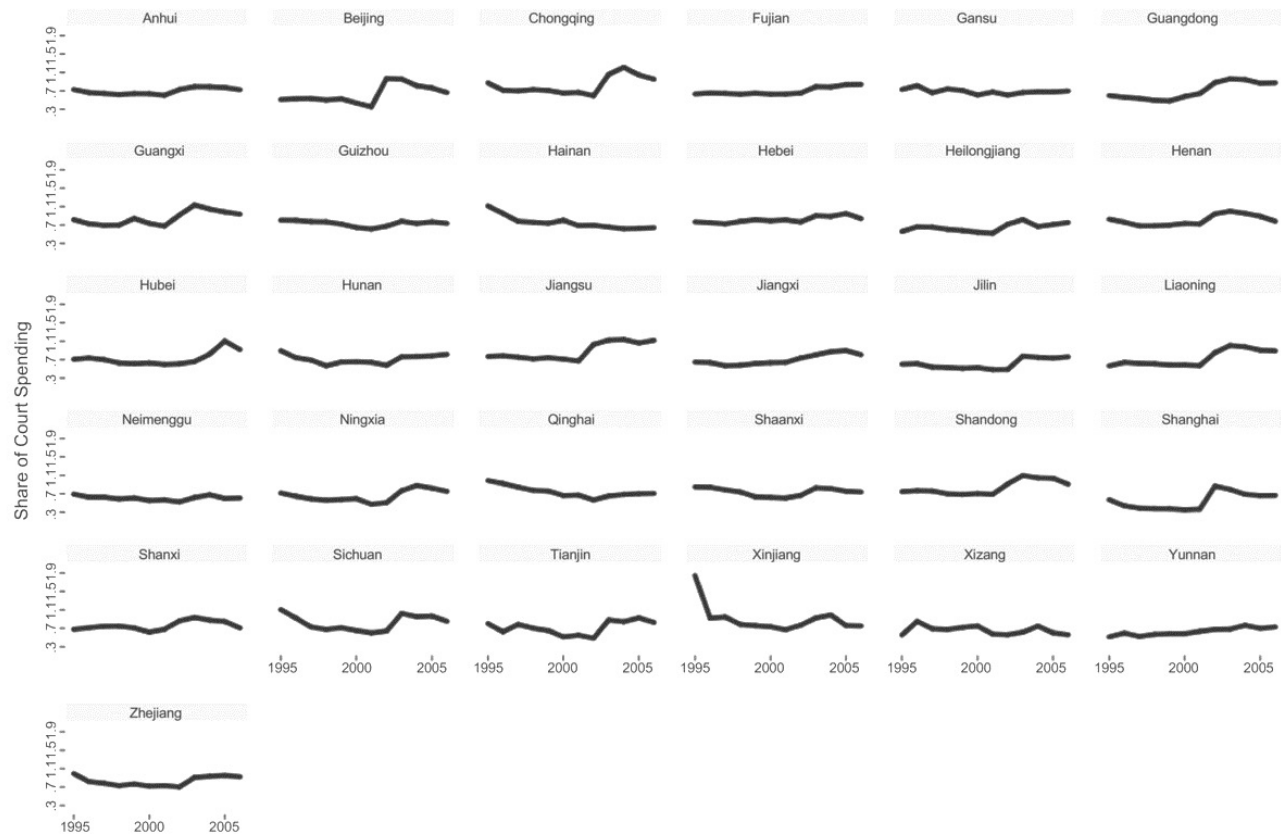
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Backgrounds: China's Judicial System



Graphs by province name in English

Year

Demand-Side: FDI

- China attracts large amount foreign direct investment (FDI)
- Foreign companies own important asset but not politically connected
 - FIEs have a limited capability to build political connections, thus more rely on court litigation
 - State-owned enterprises, domestic private companies and firms from China circle have a comparative advantage in building political connections
- Demand-side theory in play
 - In order to attract more FDI, autocratic government 'tying up their hands' to promote the rule of law
 - Yet they are only interested in improving the rule of law in commercial realm, but not in political realm

Rule of Law - Two Proxies

- **Judicial corruption:** public perceptions of the quality of rule of law
 - County level: survey of the Institutionalization of Legal Reforms in China (ILRC), 2003
 - City level: World Bank investment climate surveys of Chinese cities, 2005
- **Court funding:** government's willingness to promote the rule of law
 - Statistical Reports on Local Finance by the Ministry of Finance, 1995-2006

Judicial Corruption: Hypotheses

- As the weight of foreign capital increases in a local economy, the degree of judicial corruption in the commercial realm decreases, *ceteris paribus*
- The weight of foreign capital in the local economy is not strongly related to the degree of judicial corruption in the political realm, *ceteris paribus*

Judicial Corruption: OLS Regression

- Dependent variable:
 - Perceived corruption (county level): the proportion of respondents in each county that said “court is corrupt” in economic and administrative cases
- Independent variables:
 - **Foreign capital:** the weight of foreign capital (FDI + foreign loans) to GDP
 - Finance: the proportion of judicial expenditures in overall government budget
 - Rural: the proportion of agricultural products in a county’s overall GDP
 - GDP pc: court performance may improve with economic development

Judicial Corruption: Endogeneity

- Potential endogeneity issues:
 - Foreign investors would take into account the quality of local legal systems when choosing where to invest (reversal causality)
 - Different social norms and attitude towards the rule of law across regions
 - Different policy inclination toward the rule of law other than funding
 -

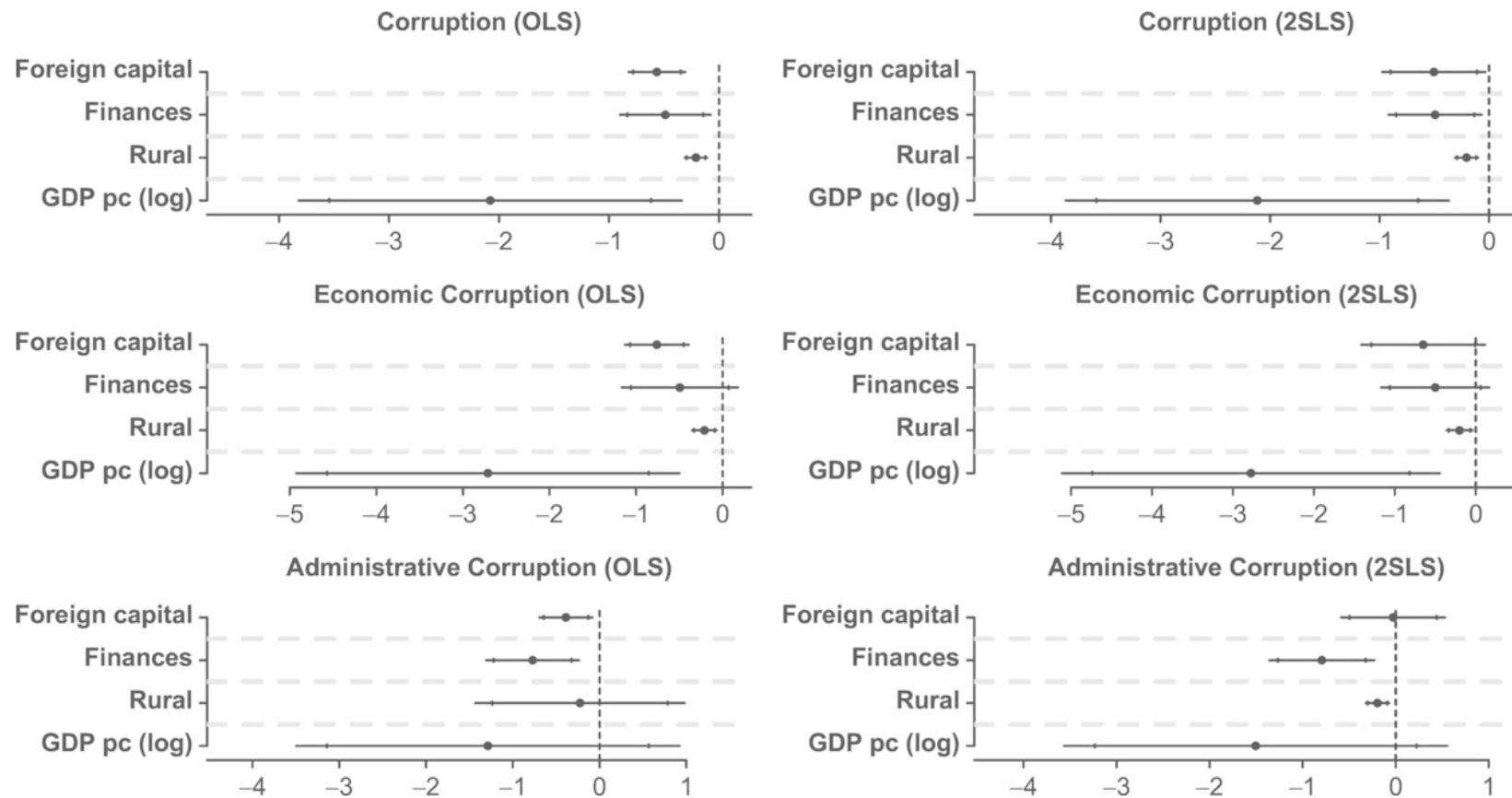
Judicial Corruption: IV Regression

- Instrument I: the **distance** to the nearest coastal open city (special zone)
 - FDI is very concentrated in these coastal cities
 - No evidence showing that the geographical location of a court is related to the level of judicial corruption
 - Distance should influence judicial corruption only through FDI
- Instrument II: a county's **migrant population** as a percentage of population
 - China's FDI is labor intensive, and favors counties with rich labor resources
 - Evidence show migrants working in the private sector have a more favourable view of the judicial system than permanent residents working in the public sector
 - Migrant population is associated only with perceived corruption through FDI

Judicial Corruption: Result (perceived corruption, county-level)

Variable	DV = Corruption		DV = Econ-corruption		DV = Admin-corruption	
	OLS	2SLS	OLS	2SLS	OLS	2SLS
	Coefficient (Robust S.E.)	Coefficient (Robust S.E.)	Coefficient (Robust S.E.)	Coefficient (Robust S.E.)	Coefficient (Robust S.E.)	Coefficient (Robust S.E.)
Foreign Capital	-0.565 *** (0.131)	-0.504 ** (0.240)	-0.759 *** (0.188)	-0.650 * (0.390)	-0.388 ** (0.156)	-0.028 (0.285)
Finances	-0.488 ** (0.220)	-0.492 ** (0.217)	-0.494 (0.343)	-0.501 (0.341)	-0.772 *** (0.273)	-0.794 *** (0.287)
Rural	-0.210 *** (0.052)	-0.205 *** (0.054)	-0.210 *** (0.073)	-0.201 ** (0.081)	-0.226 *** (0.615)	-0.196 *** (0.064)
GDP pc (log)	-2.080 ** (0.889)	-2.116 ** (0.893)	-2.712 ** (1.130)	-2.778 ** (1.191)	-1.287 (1.127)	-1.505 (1.051)
Intercept	34.201 *** (8.967)	34.265 *** (8.876)	41.037 *** (11.328)	41.150 *** (11.489)	27.063 ** (10.976)	27.437 ** (10.648)
N	94	94	94	94	94	94
R ²	0.215	0.214	0.172	0.170	0.185	0.143
F	7.000	4.760	5.530	3.390	4.530	3.200
Durbin-Wu-Hausman χ^2 test	–	$\chi^2=0.054$, $p=0.816$	–	$\chi^2=0.084$, $p=0.772$		$\chi^2=1.624$, $p=0.203$

Judicial Corruption: Result (perceived corruption, county-level)



Court Funding: Hypotheses

- As the contribution of FDI from outside the China circle to the provincial GDP increases, provincial governments in China are more likely to provide financial support to courts, *ceteris paribus*.
- The proportion of FDI from within the China circle in the provincial GDP has a negative impact on provincial governments' financial support to courts, *ceteris paribus*.
- As the share of SOEs in the local economy increases, local governments' financial support to courts decreases, *ceteris paribus*.
- As the share of domestic private enterprises in the local economy increases, local governments' financial support to courts decreases, *ceteris paribus*.

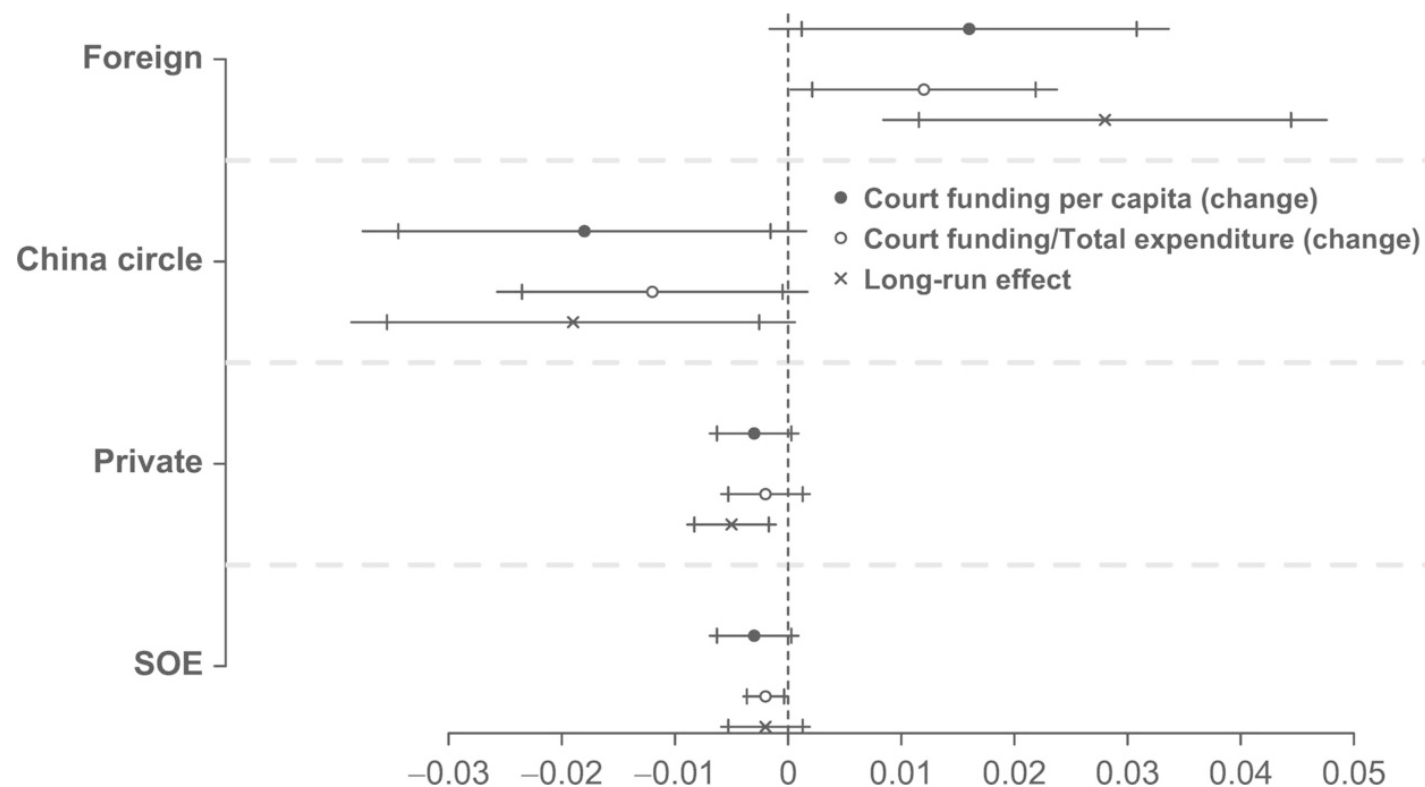
Court Funding: Model Specification

- Error correction model (De Boef and Keele, 2008)

$$\begin{aligned}\Delta \text{Court}_{i,t} = & \alpha_o + \alpha_I \text{Court}_{i,t-I} + \beta_o \Delta \text{China circle}_{i,t} + \beta_I \text{China circle}_{i,t-I} \\ & + \beta_2 \Delta \text{foreign}_{i,t} + \beta_3 \text{foreign}_{i,t-I} \\ & + \beta_4 \Delta \text{private}_{i,t} + \beta_5 \text{private}_{i,t-I} + \beta_6 \Delta \text{SOE}_{i,t} \\ & + \beta_7 \text{SOE}_{i,t-I} + X\beta + \lambda_t + \gamma_i + \varepsilon_{i,t}\end{aligned}$$

- Two measures of court funding:
 - Court funding per capita (divided by population in the region)
 - Court funding as percentage of overall government budget
- T-1: one-year lag variables
- Controls: fiscal expenditure pc, GDP pc, service sector/GDP, share of rural population, population, number of cases accepted by courts, number of law offices, number of lawyers

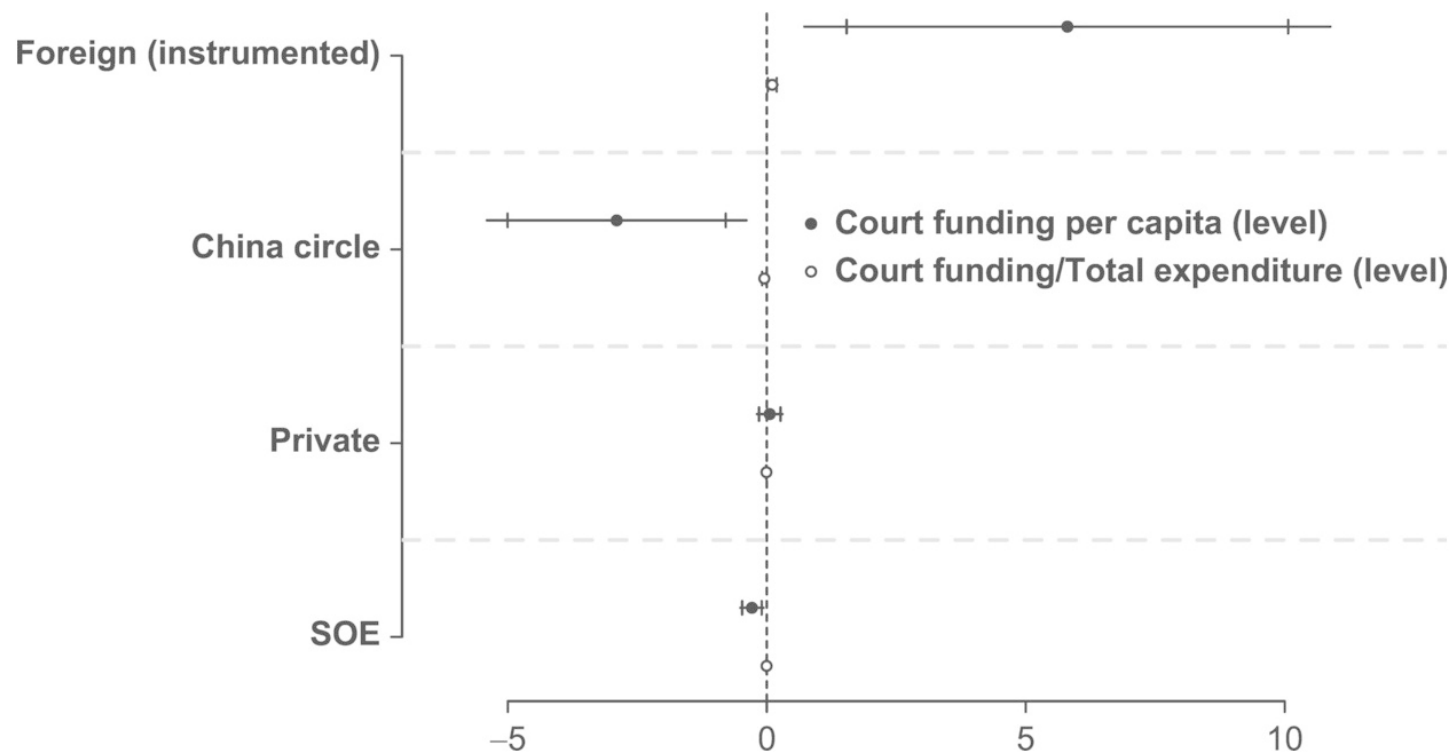
Court Funding: OLS Result



Court Funding: IV Estimate

- Instrument: 5-year lag of the **number of foreign tourists** in a province
 - Foreign investors, before they build a factory in a foreign country and put money into it, might take an “investment tour” to familiarize themselves with the local environment.
 - Tourism is not directly related to judicial empowerment: a strong court is the least important concern for a tourist when choosing where to vacation.

Court Funding: 2SLS Result



Conclusions

- The empirical evidence are consistent with the demand-side theory.
- While foreign capital from outside the China circle pushes Chinese local governments to strengthen courts by providing more financial support, Chinese indigenous firms and ethnic Chinese firms prevent local governments from spending money on courts.
- Foreign capital has influence only in the commercial realm, whereas judicial unfairness is still prevalent in the political realm to prevent ordinary citizens from challenging the authoritarian state.