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Introduction

Before the law sits a gatekeeper.

Franz Kafka

THE PUZZLE: WHY AN AUTHORITARIAN RULE OF LAW?

In 1982, six years after the turmoil of the Mao era, the Chinese Communist Party (CCP), under the leadership of Deng Xiaoping, amended the radical 1978 constitution and embraced the basic principles of the rule of law: “No organization or individual may enjoy the privilege of being above the Constitution and the law.”¹ Fifteen years later, in his report to the Fifteenth Party Congress, Deng’s successor, Jiang Zemin, declared that “governing the country according to law and making it a socialist country ruled by law” was the state’s “basic strategy.”²

Chinese leaders are not unique among authoritarian rulers in welcoming the rule of law. On September 22, 1972, after seizing control of the government, Philippine dictator Ferdinand Marcos proclaimed martial law, shut down the mass media, and closed all schools and universities. However, in a speech delivered on nationwide radio and television a day later, Marcos said, “The judiciary shall continue to function,” and he stated that his new government would have effective “checks and balances” that would be enforced by the Supreme Court in a new framework of “constitutional authoritarianism” (Carmen 1973). Anwar Sadat, an Egyptian ruler, explicitly pinned his regime’s

¹ Constitution of the People’s Republic of China (1982), Article 5.

² “Jiang Zemin’s Report at the 15th National Congress of the Communist Party of China,” available at <http://www.fas.org/news/china/1997/970912-prc.htm>, accessed June 4, 2013.

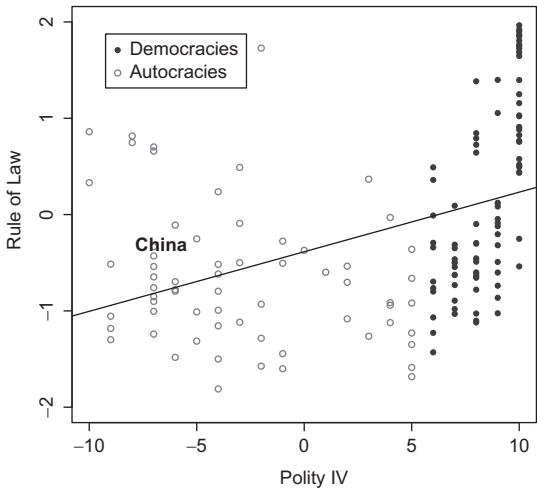


FIGURE 1.1 The Rule of Law versus Democracy (2008)
Sources: Kaufmann, Kraay, and Mastruzzi (2009) and Marshall and Jaggers (2009).

legitimacy to the rule of law and used rule-of-law rhetoric hundreds of times throughout his eleven years at the head of Egypt's authoritarian state (Moustafa 2007). Vladimir Putin, the all-powerful Russian leader, stepped down from his role as president in 2008 to become prime minister to adhere to the term limits stipulated in Russia's constitution. The list of authoritarian regimes embracing the rule of law continues. Consider Augusto Pinochet's Chile (1973–90), Lee Kuan Yew's Singapore (1959–90), Mohammad Reza Pahlavi's Iran (1941–79), and Chiang Ching-kuo's Taiwan (1978–88).

Figure 1.1 shows a scatterplot of 157 countries' rule-of-law scores (Kaufmann, Kraay, and Mastruzzi 2009) and their *Polity* scores, which measure the degree of democracy in 2008. There is clearly no linear relationship between the measures of rule of law and democracy. While democracies tend to have stronger rule of law, there is a large variation in the rule of law among authoritarian regimes.

This book addresses the following puzzles: Under what conditions would authoritarian rulers be interested in the rule of law? What type of rule of law exists in authoritarian regimes? How do authoritarian rulers promote the rule of law without threatening their grip on power?

There has been a long-standing presumption among many social scientists that authoritarian rulers who come to power by force and have unconstrained political power refuse to be ruled by the law. The Washington Consensus in the 1990s also believed that democracy, markets, and the rule of law would all develop in unison. However, empirical studies on the correlation between democracy and the rule of law are inconclusive. While some scholars have

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indeed found that democracies are more likely to support the rule of law (Leblang 1996, 22; Rigobon and Rodrik 2005), others have found no relationship. Barro (2000) argues that the rule of law occurs in both democracies and dictatorships.

I answer the aforementioned questions by examining legal reforms in China. The history of the People's Republic of China (PRC) reflects a transformation from a rule-of-man regime to a *partial* rule-of-law regime. Mao Zedong turned the judicial system into a tool for consolidating socialism after establishing the PRC in 1949. The new regime used courts to penalize counterrevolutionaries who were associated with the previous Kuomintang regime, to sentence landlords who were deprived of property and rights in the land reforms, and (during the "Anti-Rightist Campaign") to legitimize the punishment of "rightists" who criticized the party and the government. The *rule of man* in China reached its peak during the Great Proletarian Cultural Revolution, in which Mao's own words were held to be superior to any laws. The whole legal system was almost completely abolished during the Cultural Revolution, except that some courts still functioned to adjudicate cases involving "class enemies." Law schools were shut down, bar examinations terminated, and lawyers sent to the countryside.

In the late 1970s China resumed its state-building process, of which the institutionalization of a formal legal system was a crucial component. The post-Mao leadership believed that installing a reliable legal system in which there are constitutional checks on individual power would prevent political disasters such as the Cultural Revolution from happening again. More systematic legal reforms, in which building a professional, efficient, and fair legal system was the essential goal, started in the 1990s as market reforms deepened.

Despite the national progress, the development of the rule of law has been quite uneven across the country. Figure 1.2 graphs a measure of judicial corruption against per capita gross domestic product (GDP) in 102 Chinese counties. While wealthy counties have a lower level of judicial corruption, there is large variation among underdeveloped counties. This variation cannot be explained simply by modernization theory, which posits that economic development brings improved institutional performance. The variation is even more puzzling, given that China is a unitary state in which institutions are identical across the country.

My overarching argument for these cross-national and subnational outcomes is that 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*.

I define the rule of law that exists in authoritarian regimes as a *partial* form of the rule of law in which judicial fairness is usually respected in the commercial realm but not in the political realm. Authoritarian rulers have no interest in implementing the rule of law in full, which would imply both fairness and efficiency; most authoritarian rulers are unwilling to respect judicial fairness,

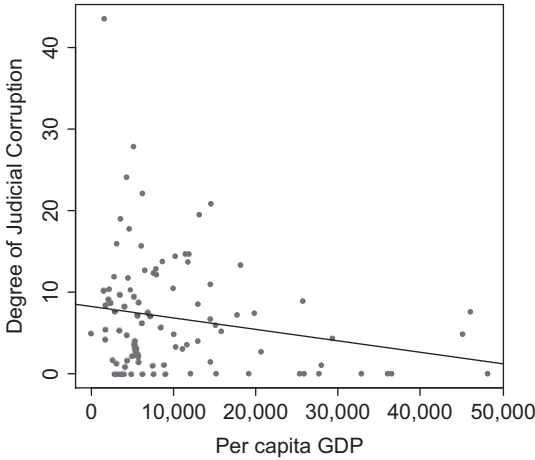


FIGURE 1.2 Judicial Corruption across Chinese Counties in 2003
 Source: ILRC 2003.³

especially when they are in front of the court themselves. Authoritarian rulers therefore face a dilemma. On the one hand, they must respect the rule of law to make a credible commitment to investors, whose assets are urgently needed; on the other hand, a strong judiciary might open new avenues for political activists to challenge the state. The solution to this dilemma is for authoritarian rulers to build the rule of law in a partial form: they sequence the legal reforms such that they “tie their hands” in commercial cases yet extend their discretionary power in the political realm. Through increasing costs, raising the bar, manipulating the procedure, lowering the benefits, and distorting the law, authoritarian rulers discourage citizens from utilizing the judiciary to sue the government.

A DEMAND-SIDE THEORY OF AUTHORITARIAN RULE OF LAW

Existing literature on the rule of law has focused on the *supply side*.⁴ Realizing that the judiciary has neither the power of the purse nor the ability to take up arms, many argue that the empowerment of the judiciary must come from the delegation of powerful politicians. Some suggest that legislators have an interest in creating an independent judiciary that can enforce the deals struck by enacting legislatures, thereby increasing the value of campaign contributions that legislators can extract from contributors on whose behalf they made those

³ The Institutionalization of Legal Reforms in China (ILRC) survey is described in Chapter 6.

⁴ For a good review of the literature, please see Helmke and Rosenbluth (2009).

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deals (Landes and Posner 1975). Some point to politicians' desire to avoid blame for unpopular policies (Graber 1993; Salzberger 1993; Whittington 2009). McCubbins and Schwartz (1984) suggest that an independent judiciary can help the legislature encourage executive agencies to adhere to legislative intent. Some contend that an incumbent legislative majority might willingly transfer some of its power to the judiciary as political insurance against being dominated by a future majority (Ramseyer and Rasmusen 1997; Finkel 2008).

Supply-side theories, while useful in explaining the rule of law in democracies, fall short in autocratic settings. Since politicians can delegate power to the judiciary under certain conditions, they can also withdraw their support under other conditions. This *time inconsistency* problem is particularly acute in authoritarian regimes, where the rulers are not bound by strong rules.

I offer a *demand-side* theory of the authoritarian rule of law. According to this theory, interest groups are constituencies of the rule of law. The theory is based on the premise that authoritarian rulers cannot solely rely on force to stay in power; they need cooperation as well – especially from interest groups that control valuable assets. Authoritarian regimes, like all states, need to collect revenues from their citizens in the form of either tax or rents. Authoritarian rulers consume part of the revenues themselves, distribute some to their loyalists, and spend the rest on providing public goods to maintain a minimum level of public support. Without adequate revenues, authoritarian rulers are unable to stay in power, satisfy their supporters (whose loyalty can be bought by a challenger), or pacify the masses (whose grievances might escalate into a fatal revolt). Therefore, to survive, authoritarian rulers need the cooperation of asset holders, whose valuable assets can be taxed or confiscated.

The exchange between the ruler and asset holders, however, is a bargaining process. Asset holders exchange their assets for policies. By granting asset holders' preferred policies, the ruler can secure their compliance. Otherwise, asset holders can hide, destroy, or move their assets. In this bargaining process, the ruler's *power* is determined by how urgently she needs the assets. In situations in which revenues are necessary for the ruler's survival – such as during war, crises of legitimacy, and the consolidation of power – the ruler is willing to sacrifice some of her benefits to seek the cooperation of asset holders. In addition, the ruler's *preference* in the bargain is determined by the costs of policies. Some policies, such as building a fair and efficient legal system, are costly for the ruler, because the ruler has to treat everyone equally, which means taking privileges away from the politically connected. This will decrease the amount of rent that the ruler can extract from privileged social groups.

On the other side of the bargain, asset holders' *power* is determined by how organized they are, and by the value and mobility of their assets. Organized interest groups have stronger bargaining power than unorganized groups. Asset holders can organize themselves via associations, clubs, or unions. A centralized hierarchy can help them overcome collective action problems. Furthermore,

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asset holders with large assets that can significantly contribute to the ruler's revenues have more power than those with few assets. Therefore, economic elites who control abundant wealth have a stronger voice at the bargaining table than the "have-nots." Finally, the mobility of assets gives asset holders more leverage vis-à-vis the ruler. Interest groups with mobile assets can credibly threaten to exit by moving their assets away from the ruler's jurisdiction. Mobile assets also make it easier for asset holders to hide from taxation or confiscation. In summary, organization and valuable and mobile assets empower interest groups by enabling them to withdraw (or threaten to withdraw) urgently needed cooperation from the ruler.

Asset holders' policy *preference* is a function of their existing or potential political connections with the ruler. Each asset holder as an individual would naturally prefer privilege to a level playing field, because the former grants one a monopolistic position in the market where rent can be generated, whereas everyone must compete fairly in the latter. However, privilege, by definition, cannot be granted to everyone. Interest groups must compete for it. In the competition for privileges, some are disadvantaged by their skills, prior political connections, and ability to build new connections. Therefore the advantaged will hold on to their privileges, while the disadvantaged will seek a level playing field. Politically connected groups and individuals do not favor the rule of law, which creates a level playing field for all asset holders. Interest groups with political connections seek to maintain their privileges, whereas those who are not politically connected will advocate the rule of law, under which everyone is treated equally. A strong judiciary protects contract and property rights, makes dispute resolution predictable, and speeds up the litigation process. The privileged interest groups will block the leveling of the playing field to eliminate competition, whereas the disadvantaged groups will push for judicial empowerment to create a fair competition environment.

THE SUBJECT: WHY CHINA?

I illustrate the demand-side theory based on an empirical study of contemporary China, which offers several advantages in testing such a theory. First, China is one of the most durable authoritarian regimes in the world; single-party rule has lasted for over sixty years. The regime has remained resilient in the face of the "third wave" of democratization and the "Arab Spring" in which many closed autocracies have collapsed. Second, China has made significant progress in its domestic legal reforms. Many scholars and pundits believe that it has transitioned away from a rule-of-man regime, in which Mao Zedong ruled by his personal will, and started a "long march toward the rule of law" (Peerenboom 2002). Finally, China offers considerable heterogeneity across regions. The large number of subnational units offers an ideal laboratory

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in which to test theoretically driven hypotheses in a large-N context while controlling for institutional factors.

AUTHORITARIAN RULE OF LAW WITH CHINESE CHARACTERISTICS

To apply the theory in China, I ask the following question: under *what* conditions would the Chinese state make *what* policy concessions, and to *whom*? My answer, in brief, is that the Chinese authoritarian state, under the leadership of the CCP, is a revenue maximizer. To increase its revenues, the state cooperates with economic elites who pay taxes and generate rent. Interest groups, represented by state-owned enterprises (SOEs), domestic private enterprises, and enterprises owned by ethnic Chinese, have strong political connections in China, whereas those represented by foreign-invested enterprises (FIEs) do not. Politically connected interest groups monopolize privileges and therefore prevent the equalization of the playing field. Governments that rely on politically connected interest groups for revenues will block significant legal reforms that increase judicial fairness. In contrast, interest groups that are not politically connected will push for judicial empowerment to prevent favoritism and establish a fair commercial environment. Governments that rely on these interest groups will need to tie their hands, disentangle their ties with the privileged, and respect the rule of law in the economic realm. Specifically, we expect to observe better enforcement of the rule of law in regions with a large number of foreign investors but a higher level of judicial corruption and judicial inefficiency in regions heavily invested in by domestic and ethnic Chinese investors.

However, Chinese local governments have no incentive to strengthen courts in every respect. A fair and efficient court will not only protect investors whose assets are crucial for local officials' political advancement but also provide openings for discontented citizens and social groups to challenge the state, which undermines the officials' careers. Therefore, the best strategy for the government is to curb corruption in the commercial realm while imposing constraints on citizens' rights to sue the authoritarian state through legal channels. *Ex ante*, this is achieved through the Communist Party's power to selectively intervene in judicial decisions; as an *ex post* remedy, the Communist Party can manipulate the setup of anticorruption agencies to gain a "first-mover" advantage to protect corrupt party officials.

CAUSALITY

This book describes China's journey from investment to the rule of law, rather than the other way around. Foreign companies entered China for reasons other than the rule of law: most of them were attracted by the big market,

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incredibly low labor costs, and access to the East Asian market. They were confident in their investment because of commitments made by individual Communist Party leaders rather than a sound legal system. Foreign corporations invested in China in the hope that they would be privileged; some indeed were, but most were not, and almost all of them lost their privileges as the number of foreign companies increased and the Chinese leadership changed. Foreign investors were frustrated. Their strategy then was to lobby the state to strengthen its formal legal institutions. The following cases help bring the theory to life.

In 1978, when Deng Xiaoping announced that China would open up, a “dream market” was created for Western corporations. This was an old dream that had beguiled Western companies since the Industrial Revolution. One British writer declared more than 170 years ago, “If we could only persuade every person in China to lengthen his shirttail by a foot, we could keep the mills of Lancashire working round the clock” (Mann 1989, 24).

American Motors Corporation (AMC), once the fourth-largest auto company after the Big Three (General Motors, Ford, and Chrysler), was sustained in the 1970s largely by a single, highly profitable product – the Jeep – yet AMC never grabbed more than 7.5 percent of the American car market.⁵ Tod Clare, AMC’s vice president of international operations, a Stanford graduate who majored in international relations with a special interest in the Far East, had been eyeing China ever since Nixon’s visit in 1972. In 1978, Clare felt that it was time to drive AMC to China.

There were at least three attractions of doing business with China. One was the big market. Ralph A. Pfeiffer Jr., chairperson of the board of IBM’s international division, said in an interview, “You never know what would happen if they really got going. Japan’s got only one-seventh of China’s population... If we would just sell one IBM PC for every 100 people in China, or every 1,000, or even every 10,000...” (Mann 1989, 54). By establishing a presence in China, AMC could gain some competitive advantages over its major global competitors. General Motors (GM), the world’s largest automaker, was not very aggressive in the world market. Clare thought that GM “wanted to sit back in their offices at home and write orders” (Mann 1989, 39). Access to a market with a billion people would help AMC catch up with the Big Three. It would also help AMC compete with Japan: China could become a base from which AMC could export cars throughout the rest of East Asia, whose market was then dominated by Japan.

The second incentive was the incredibly low labor costs. In the early 1980s, American auto companies were paying wages of roughly \$20 an hour, while their Japanese competitors were paying \$12. Making cars in

⁵ The Jeep case is largely borrowed from Mann (1989).

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China, where workers were paid the equivalent of sixty cents an hour, might help even out the difference.

The third motivator was national interest. Starting in the late 1970s, the United States was eager to develop strong commercial ties with China to counterbalance the Soviet Union. "Our new ties with China are of fundamental importance to the United States, and to the prospects for a peaceful and prosperous world," Deputy Secretary of State Warren Christopher told the U.S. Congress in 1979 (Mann 1989, 54).

All the attractions created what the *Wall Street Journal* called "a gold rush aura"⁶ or what the *Economist* dubbed "China fever"⁷ in the 1980s to 1990s to invest in China. From 1979 to 2000, China absorbed a total of \$346.2 billion in foreign direct investment (FDI) (Huang 2003, 6), which made it the second-most attractive destination for foreign investment after the United States.

However, systematic legal reforms in China did not start until the mid-1990s. Jiang Zemin, then the party general secretary, made "ruling the country in accordance with law" a "basic strategy" in 1997, and the phrase was incorporated into the Chinese constitution in 1999. Most scholars agree that meaningful legal reforms started only in the late 1990s (Peerenboom 2002, 58–59; Clarke, Murrell, and Whiting 2008, 399).

Without the rule of law, why did foreign companies rush to China? It was certainly not "drinking the Kool-Aid"; they went to China hoping they would be privileged. In 1979, when AMC executives sat down with their counterparts from the Beijing Automotive Works (BAW) to draft a contract for a joint venture, AMC insisted on an "exclusivity" clause guaranteeing that it would be the sole foreign manufacturer of four-wheel-drive vehicles in China. "If the company was going to start up operations in China, it wanted to be sure it had a preferred position there" (Mann 1989, 46). The Chinese refused to write this into the contract, but AMC did obtain "a preferred position" by building strong political connections in China.

AMC's intermediary, C. B. Sung, was a well-connected Chinese national who was a good friend of Zhu Rongji, who became the Chinese premier in 1997. Sung's wife, Beulah, was a family friend of Rong Yiren, a Shanghai millionaire who was later elected China's vice president.

In 1986, the one-year-old joint venture, named Beijing Jeep, was in trouble: it was short of foreign exchange to purchase auto parts from the United States. Don St. Pierre, the manager of the joint venture, tried to solve the issue by negotiating with his Chinese partner, but nothing worked. He finally decided to go to the top. He talked to Hulan Hawke, a Chinese-American woman working

⁶ Frank Ching, "China's New Economic Zones on Trial: Special Areas Attract Billions in Investments," *Wall Street Journal*, August 12, 1982, p. 23.

⁷ "Not Quite So Sparkling China," *Economist*, March 1, 1997, p. 38. <http://search.proquest.com/docview/224102560?accountid=14707>, accessed June 7, 2013.

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in C. B. Sung's company and the daughter of an important Communist Party official. They decided to write to Zhao Ziyang, the Chinese premier, who was known as an open-minded reformer. Mrs. Hawke promised to put the letter into Zhao's hands.

After drafting the letter with St. Pierre in both English and Chinese, Hawke gave it to a Chinese friend, a woman who had access to China's top leaders. St. Pierre suspected that the woman might be Zhao's daughter. Several months later, St. Pierre was sitting in an office in AMC's headquarters in a suburb of Detroit when a telex arrived from Beijing. It was from Zhu Rongji, then the deputy head of China's State Economic Commission. Zhu said he had been entrusted by Premier Zhao to resolve the problems at Beijing Jeep. Beijing Jeep was subsequently guaranteed \$120 million in foreign exchange.

Beijing Jeep's story had a happy ending, but it is far from a typical one. The company was privileged because it was the first big joint venture in China, and the Chinese government wanted to make it a "model joint venture." The Chinese did not want to extend the same deal to other Western companies, so the final section of the written agreement with Beijing Jeep swore both sides to secrecy.

Outside the "model," other foreign companies were not as lucky. In 1994, Beijing ordered McDonald's to vacate its 28,000-square-foot site so that an enormous commercial and residential development called Oriental Plaza could be built by Hong Kong tycoon Li Ka-shing, who was a close friend of Jiang Zemin, then the party general secretary. That administrative order violated the twenty-year contract signed between the company and the Beijing government in 1989.⁸

Even the politically favored Beijing Jeep faced uncertainties as China's political climate shifted. In 1987, the party's general secretary, Hu Yaobang, was ousted from power. In the following weeks, there were signs that some Chinese leaders favored a return to orthodoxy. "We must rely on our own efforts," said the *Workers' Daily*, a party paper. "Capitalists are capitalists. They will never be so generous as to assist a country like ours without benefiting themselves" (Mann 1989, 266). In a meeting with a delegation of French officials, China's then vice premier, Li Peng, said, "You must be psychologically prepared for some projects to be rejected or restudied" (Mann 1989, 266). A couple of years later, one day before the Tiananmen Square massacre, Beijing Jeep's highest patron, Zhao Ziyang, was ousted as well.

Political connections are costly to build and easy to lose. Very few investors, such as Li Ka-shing, are able to befriend China's top leaders; most seek connections with local officials, who are nonetheless constantly rotated across localities. The key, then, is the ability to build new connections. However,

⁸ "After 2-Year Dispute, McDonald's to Move Showcase Beijing Site," *Bloomberg Business News*, December 2, 1996. <http://community.seattletimes.nwsource.com/archive/?date=19961202&slug=2362871>, accessed June 7, 2013.