

**Task Force on Institutional Design for China's Evolving Market Economy  
Follow-up Meeting**

*Calder Lounge, Uris Hall, Columbia University*

Feb 8th, 2007

*Comments on Analytic Frameworks and a Research Agenda*

*Joseph E. Stiglitz*

Behind the agenda and the institutional issues being discussed are a large number of analytic issues. One of the important tasks of the task force should be to bring these issues to surface, to clarify the underlying models of the economy and human behavior which underlay different perspectives, and to identify areas of theoretical and empirical research which might help in assessing the merits of alternative approaches.

The exercise in which the task force is engaged can be viewed as one of “law and economics,” a subject which has until recently been dominated by the Chicago School. Underlying their analysis are assumptions of rational and well informed consumers interacting with profit maximizing firms in competitive markets, in a world in which there are perfect risk and capital markets. Central to that school is a focus on efficiency, and central to that is the notion that clear and unambiguous assignments of property rights lead to efficiency (the Coase Conjecture). More recent discussions of transition have emphasized the Political Coase Theorem, arguing that the assignment of control rights, even before there is a clear rule of law which specifies how those rights might be used or abused, will lead to the adoption of a Rule of Law, with clearly specified property rights. Underlying this school is the view that distributional issues can be separated from efficiency issues (the neoclassical dichotomy).

The conclusions of this particular school are increasingly coming under question in a variety of areas (e.g. competition law, property law). One of the objectives of the China Task Force may help articulate and develop alternative frameworks, e.g. in which the competitive model with perfect information and perfect markets is viewed as providing a flawed model of the economy; in which there is as much concern about equity as efficiency, in which law is seen as much as protecting rights (equities) as it is in enhancing efficiency; in which it is recognized that the neoclassical dichotomy between efficiency and equity does not in general hold; that markets are often characterized by incomplete contracts, and that how the “law” completes the contracts (the presumptions that are established) has both equity and efficiency effects; that contracts are often engaged in between parties of unequal bargaining power, and that the law may be able to help redress these imbalances.

Some of what I am referring to here is known as the “New Institutional Economics.” This is especially true of analyses based on models of imperfect information, transactions costs (Williamson, among others), and game theory (Aoki, Greif, among others). I hope that as we discuss these policy issues, we can use the opportunity to push the analytic frontier a little further. For instance, much of the discussion in the first part (Foundational Issues) will, in one way or another, be related to these analytic issues; but

the issues have been framed in ways that are still not closely related to the kinds of mathematical models used more commonly by economists and mathematical political scientists.

But many of the issues are, I think, amenable to such analytics. Take, for instance, the issue of land property rights. There is an analytic question: What will be the distributional and efficiency consequences of allowing individuals to sell (without restriction) their land? To answer this question, one can construct a dynamic model of land ownership, which specifies the conditions under which individuals sell (or buy) land, e.g. illnesses of parents for which there is a medicine that is available that can provide treatment, but for which the public sector will not pay; the societal costs of inequalities in land ownership (or more accurately, the agency costs associated with a disparity between labor and land ownership). Such a dynamic model could describe the incidence of landlessness, the consequences of which in turn may depend on the pace of job creation in the urban sector, and the levels of education in the rural sector. Finally, one could contrast the outcomes of unrestricted property rights with a system in which individuals are allowed to mortgage (a fraction) of this year's output, but not the land; there would be a short run static inefficiency, arising from capital market imperfections (the extent of which might depend on other attributes of the capital market), but this short run inefficiency might be much less than the long run inefficiency associated with the greater agency costs arising from more extensive landlessness that would emerge in a system with unfettered rights to sell.

Theoretical analyses along these lines should be supplemented by (informed by) more empirical analyses of land transactions in China: who has been buying and selling land, and what have been the consequences? To what extent does the lack of full ownership rights reduce investments in improving land?

One area in which the analytics are well developed is that of competition policy. The EU is currently in the process of rethinking the role of private enforcement. Recent decisions there as well as some decisions in the U.S. reflect a clear rejection of the Chicago view. The paper on Competition Policy should clearly begin with a discussion of these analytic issues. But presumably, the analysis should hone in on the question, are there aspects of China's economy which strengthen the argument for one analytic framework or another? How does one think of competition policy where "owners" are townships and villages, which are not rational, profit maximizing (value maximizing) firms, but which pursue other objectives. Clearly, the standard tests for predation in the U.S, which are predicated on the hypothesis of value maximizing firms, are simply inapplicable to such enterprises. Are there alternative criteria that should be introduced? Should the test for predatory behavior for TVE's be different from those of conventional private firms?

An area which is particularly amenable to the further development of analytic frameworks is intellectual property, with models focusing on knowledge as a public good, the role of knowledge as an input into the production of knowledge, the consequences of "privatizing" some knowledge that was in the public domain (raising its price), etc. There has been some analytic work comparing prize systems and patent

systems, but there is scope for far more. Little of this work has been applied to a country such as China which is a large knowledge absorber, but it beginning to be a knowledge producer; one can look at the optimal intellectual property regime for a country trying to free ride on the research of others, but also trying to encourage a private sector capable of earning knowledge rents.

I hope in the course of our discussion, some attention will be paid to the kinds of analytic frameworks that can be employed to inform the discussions of the choice of alternative legal and institutional frameworks, and that can be used to help buttress the particular positions being advocated.