

**NOTES for Task Force on  
“Institutional Design for China’s Evolving Market Economy”  
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**Aug 8<sup>th</sup>, 2006**

**Overview:**

**Joseph Stiglitz**

China adopted its 11<sup>th</sup> five year plan this March. We thought there is a need for better institutional design for China’s evolving market economy. This task force is a project led by Committee on Global Thought at Columbia University. Katharina might say some words about it.

**Katharina Pistor**

This is a new initiative that the president put thought. The Committee on Global Thought is based on the Columbia Community. It takes into account people that come from different disciplines to tackle issue of globalization. We will also have post graduate seminars starting next year.

**Joseph Stiglitz**

We brought people coming from different disciplines, which will make the discussion a bit difficult since we are bringing non economist with economists. We thus want to emphasize the diversity of perspective. We also want to get a better understanding of these different perspectives.

Let me say a word about we hope to get out of this day. Our original concept was to think about developing a course that would be taught at Beijing, Columbia or Manchester that would focus on the institutional design that would help understand these issues not only on china but on institutional design and legal structures in general. Knowledge is a public good so a lot of this would be better if it was in the public domain and have an impact on policy making. One possible output of this would be a book. At the end of tomorrow we will visit the question of where we want to go from here. When should we meet again, how we should meet, where and the format.

The structure of the program itself is influenced by going from fundamental topics and who we were able to get today and tomorrow. We thought we would begin by talking about the most fundamental issues such as corporate governance and property rights. We

will spend time today on those foundational issues and tomorrow on sectoral issues which are more specific.

### **Lan Xue**

I am very pleased to have this opportunity in this interesting cooperation between institutions. Since March when Prof. Stiglitz came to china we have been thinking about some of the issues and particularly about reform and its characteristics and possible sorting out. In general, the reform is guided by more particular concerns rather than ideology. A lot of the development process has been lead by the reform process. In china, in the government and academic institutions everyone thinks that reform is good. This will push for a new demand for reform which is like a cycle. All of this within the general context of maintaining the political institutions in line. How do you move from these flexible fluid situations to this more structured stable one which I think that china needs. I was one of the people that were lobbying for the reform of public institutions. There seems to be a need to institutionalize some of the reforms that have happened over the years. The key issue in the set of reforms I was lobbying for is on which the university wage should be based on for a professor. There is no coherent strategy in china at the time. It is more a demand driven one where there are problems. The government has proposed in the past few years some reform initiatives but there have been no implementation paths and how you can move forward along these lines. Those are some the things that we can see as challenges. The current leadership has established themselves as legitimate and can push for their second term to be one where they institutionalise their reform. From a policy side, this could be valuable and also contribute to the scholarly talk on china.

### **Alistair Ulph**

We have established the Center for Chinese Studies: We will be admitting our first undergraduate and post-graduate cohort. The undergraduates will be majoring in the study of China.

We are also involved in international collaboration with other universities. The faculty recognizes the importance of growth in china and how the west will have to interact with this growth. The broader approach in understanding language and culture is in line of our study of china. Manchester has the largest community of Chinese in the UK.

### **Katharina Pistor**

How to really rethink teaching and some of the broader issues that interest as all. Let me start by talking about teaching of law in American law schools. In today's world we have to think how we teach comparative law. I think we need to put some large emerging markets such as china, Russia and India in our thinking in trying to understand those legal systems. We can confront a situation where our students have to go into a system where they are forced to understand those legal systems, deal with them and navigate through them. Some lawyers have become technocrats and are not able to think beyond. This will also help us in understanding policy, it ill help us benchmark Chinese institutions vis-à-vis the institutions that we have, I think his is wrong, we have done this but it didn't work. If we want to move of this benchmarking and applying best practices. How should

we go about thinking about china or other countries? We need to rethink institutional change a policy making. What are the problems that china faces and its particular cases. How are countries able to reinvent themselves over and over again? We need to understand the underlying mechanisms. We also need not compare always to countries like the US but other countries that have had problems and look at the process they used in finding solutions. We also have to put the historical process in perspective.

### **Joseph Stiglitz**

Just as an example of the benchmarking concept we mentioned, there has been a lot of discussion about property rights. And if you listen, china is always criticized for not following your benchmark. While many of us think that our system is full of flawed. One of these issues getting intense focusing attention. New interest groups are going to be created based on the decisions that will be taken in the next ten years. This is a stage that will have a more open debate and that is why it is more exciting.

### **Liu Hong**

This meeting is very interesting. China has a very strong desire to be rich but doesn't have a vision. The economy is much complex and larger now. This conference might help establish a vision.

### **Christine Wong**

Working with the Ministry of Finance you get a sense that the situation is different today than it was in the past. The central government has a lot of money and they are pumping money into redistributive channels but they are doing this so badly.

### **Lawrence Lau**

If you think of the early Chinese reform it was kind of a boot strap thing. There were no economists trying to think of what to do. The best description is crossing the river by touching pebbles. Today is very exciting about thinking about what is next and what can be done. Let me make two points. One, institutions that we design have to work in china and thus it would have to fit in china and not a generic type. Let me give one explanation of reform in the mid 80s as part of the reform in moving into the market, this turned out to be one of the best reforms it was built, and the exciting central system and it had an inherent system of protecting the different interest you need the very precise foundation of central planning and then move to the market system. We need to thus take the initial conditions into account.

In order to design institutions we need to have some social welfare function in mind. The CEO has no problem appointing the deputy CEO. You can't fire your deputy. From an organizational perspective this doesn't make sense. We don't have a unified managing system. So when we talk about incentives for the CEO it doesn't make sense because he/she are subject to limitations. We need to think about these limitations. This keeps on happening because it keeps on giving control and channel of information for people in power. We need to think through what these people are thinking. We need to think if we have a product that we are selling that people want to buy.

**Francesco Saraceno**

What are the conflicts that are arising? What thing that struck me is the capacity of the elite that is endogenous system of solving problems. Why should we worry today? Why don't we want to think that this gradual system will resolve the problems. I say so because I think the success of the system is the best way to understand how we can solve the problems. What are the problems in the future that are not solvable?

**Katharina Pistor**

This is the key issue but the government itself in china is committed to institutionalizing the system, they feel this need for institutionalization that means that there is a need for decisions to be made maybe in a step by step format but they are keen on making it happen.

**Francesco Saraceno**

Maybe I didn't explain myself. What I am trying to say is there is a need to understand what the real risks are because I don't see so many.

**James Galbraith**

The origin of the ideas don't come from china but from abroad. We need to organize on how our discussion fits into the Chinese setting.

**Chengang Xu**

The Chinese economy has been changing over the past few years. It is the kind of step-by-step institutional change. The reason for the changed is not an outcome of Chicago driven policy but rather as an outcome of the need to change since the firms were in problem and they were privatized.

## *Institutional Development and Institutional Design in Comparative Perspective:*

### *Rethinking institutions and institutional change: the theoretical challenge*

#### **Patrick Bolton**

The emphasis here should be on the challenge. From an economist perspective it is a huge challenge where we think in terms of aquarium outcomes. We used to think that markets and institutions are given as being black boxes. We never used to think about firms are formed and how they operate. From an economist point of view it is a challenge. I have more questions and thoughts rather than throwing an agenda. Institutionalization and trying to achieve stability is very important. After the referendum in Europe for the constitutions, the whole dynamic of institutional change in Europe stopped. We don't know when it will start again. We ought to bear in mind that reform comes with its own dynamics.

I really want to make three points:

1. I want to set a little background on what happened in transition from planned economies to market ones and make comparison to transition companies.

By contrasting China with Soviet Union, what was the Chinese mode of the transition process? It was a process that was managed by the Chinese communist party. This is a fact that it is overlooked by scholars. This is a fact that we need to revisit and see why the role of the party was so important in this change. We are so used that dictatorships are bad and that communist parties are bad and that democracies are the only good thing.

While there was a move towards the market there was an effort to have a market infrastructure. The government changed its role into regulating markets. If we contrast that with USSR, Soviet union economists came in like André Schliefer and Jeffrey Sachs came in and were advocates of a big bang change. The worst that one could do they were arguing was a gradual change. Russia is still paying the consequences of such reforms and the damage made. Another point in contrast, was to keep a role of a central planner in China but not in USSR. What institutional reform means is introducing legal systems that protect shareholders. The experience in china contradicts this view. All studies on law and development exclude China. China is always not in. Katharina Pistor wrote a paper showing that the size of China is bigger than that of all the data points. So if you look at the Chinese provinces rather than China as a whole, then the results will change completely. That is not we mean by institutional change by protecting investors and introducing common law systems. The huge theoretical challenge as economies sit down by looking how firms' internal organization changes. We really need to understand the state in fostering and controlling the transitions process. We need to understand how the state is set-up.

Institutional change is all about slowly overcoming political changes.

Schander's literature: Another relevant literature is as market grow there is more planning and information feedback needed. It is the visible hand (firms) that is the driver rather than markets.

Let me also mention Acemoglu and Robinson: the institutional change in the spread of democracy in the west was driven by fear of revolution.

Ragan and Zingales emphasize the idea that market economies tend to create concentrated wealth which sets up impediments on markets and then institutions should be used to take down those barriers.

### **Charles Sabel**

Let me start by connecting the discussion to what has been said in the beginning about this fluid nature, pebble stepping, boot strapping of Chinese reform. There seems to be two views of this of what is the general characterization of the Chinese growth. One, it works and the second, it is dangerous and can't last and it needs to be replaced by institutionalization.

I want to propose another alternative. Institutions that can generate their own make up on the way. China has grown by a process that can only be called experimental. Does it have to be rescued now by the most conventional set of institutions? I want to say that china is the leading macro example of form of institutional experimentation which is common now. What I want to emphasize is again at the level of organizational design is that the idea that institution creates their own context which induces people to build their own markets. Institutions are context free because they create contexts. The ideal institutions are one that both creates context and is immune to it. This leads to the view that institutions are endowment. If this endowment view of context free for big bang view was true, then countries will be stable and countries of the same type will be growing the same. This is not true. There is huge heterogeneity by geography and firm type which you would expect in the endowment view. Also, there are institutions of collective learning that are different in different epics of growth. There is heterogeneity within developing counties and within any open economy institutions have only meaning in comparison within other institutions,. By putting all this together, different types of heterogeneities and contexts you like to set up institutions that could use the set-up of spontaneous available growth.

Could we have institutions that are designed to identify constraints and bottlenecks and possible ways of overcoming them? Do they exist? From the real world we know that they exist and that was Toyota style institutions. The big bang in institutional design has been the discovery and generalization of Toyota style institutions. Let me illustrate how they work. If you have production, you have a normal assemble time and you strip out all the inventory. If something breaks, you have to fix it directly because there is no inventory to replace it. If you don't find the deep cause of breaking down, then machine will break down again. To keep production going, you need to improve it. Discover where the constraints are and go through a procedure where the disruption is. You know

that the source of destruction is a defect that might have been introduced at an early stage of development. Finding problems outside the routine is also important.

In actual benchmarking you benchmark things that are like what you want. Determining what are alike is very difficult. You have to have a debate about what things are alike. There is no right thing. The reason organizational revolution succeeds is because they respond to the bounded rationality concept. The key thing is hierarchical disaggregation, aggregation. The alternative is to find people that are solving part of the problems you are solving. The shift will be a network one where you look for people that are solving these problems.

There are classical institutions that are good in this specific context. Something in the features of those institutions allows it to solve those governance issues. Governance is a method to compare agents output with the principal goals. The alternative is a peer-review: A framework goal with revision.

### **Lessons from transition economies in Eastern Europe and Former Soviet Union**

#### **Erik Berglof**

I am going to speak more about the outcomes of transition countries. I am going to start with the Eastern European countries rather than Russia. There is a huge diversity. If you look at the outcome today there are a lot of common features in those countries. If you look at the core economic model- entrepreneurial capitalism- a capitalism that is based on strong owners evolved in management. If you look at the financial system they are dominantly bank oriented with market playing a limited role but a bigger role than they used to play historically. There is a strong presence of foreign ownership especially in the banking system.

In terms of the legal element of this there is convergence driven by EU accession. If you look at the political-socioeconomic system- there is a lot of forms of governance systems. They took on a lot of obligations as part of the transition because they wanted to protect a lot of losers. On the other hand, now, there is a lot of push for tax competition and attempts to bring a lot of the tax base into the system. Most of these countries are either part of the EU or are trying to enter and this affects local politics.

They are very pre-mature democracies. Very few governments have been re-elected. The political system is very fragmented and a lot of fluctuations in terms of attitude and values. There is a lot of unhappiness and a lot of discontents with the outcomes of transition. Despite this success of transition they have distorted images of what is going around. From the political decisions they are unable of developing reform from the center.

There is a string of economic integration with the EU and the rest of the world. They have very open economies to direct investment trade. If you look at the trade re-orientation there has been a lot of re-orientation since the beginning of the decade.

While China has doubled the level of R&D those countries are at the level of China in the mid 90s. This demonstrates the inability to generate resources at the core. Very little of R&D are taken by subsidiaries of foreign firms. Those economies are becoming peculiar in the sense that they are not attracting R&Ds. The challenge of creating innovation is central. Brining in public and private partnerships is legally and politically hard. There is also a demographic issue.

Role of outside anchor, the politics of those countries would have been so hard to implant these changes.

### **Lessons from China**

#### **Chengang Xu**

One of the most important lessons we should learn is that institutional design should be incentive based. Most of the reform programs designed for transition countries are designed by the macro economists with the grand goal of converging those countries. The issue is how those are designed. Are incentive compatibility taken into account? When incentive compatibility is taken into consideration then we have some control. This is not something new. Historians have been discussion how institutional change is path dependent. Perhaps one of the reasons is that existing institutional set-ups are linked to existing stakeholders which might resist reform. One of the clear goals of Washington Consensus was privatization and protecting property rights. The aim is to keep incentive compatibility in line.

Each evolutionary change will create new stakeholders which are themselves prone to resist future reform.

Before the reform China was decentralized. In 1970 there was a big push for the 5 small industries. That was the initial condition before the reform started. The regional governments are the biggest stakeholders. Reform meant allocating power to the latter group and that is incentive compatible. Regional decentralization led to the incentive to compete across regions. Most of the successful reform measures were based on experimental methods. Special economic zones started in few cities and then were extended to other cities for example. The earlier reforms are all incentive compatible.

How important are regional governments today for the operation of firms?

We use a survey and randomize over 3000 firms. We look at all kinds of firms in terms of ownership and find that all reports show government influence to be extremely high. The basic message, no matter which region (successful or not), they all regard the support of the government as being substantially important.

#### **Athar Hussain**

I would like to emphasize the context within which the Chinese transitions happened.

- The transition from socialist economy to a market oriented one.
- Transformation of an agrarian one to an industrial one.



The role of the communist party is playing a really key role in keeping the country together. All appointments are made by the one party. The characteristic of the legal system are secretive and you don't even know who the judge is.

One of the surprises of the transition process is in public finance. What has happened in China is a rapid decline in government revenue to GDP, but this had no effect on social expenditure. Part of the change is not only government drawing from industry but reducing health and education expenditures to households, and this has an effect on inequality. It is not only inequality by region but also intergenerational inequality.

**Discussion:**

**Lawrence Lau**

Pareto improving is a much better description rather than incentive compatibility. If you insist on making people worse off you guarantee opposition. Chinese reform guaranteed that no one loses. Corporate forms and substance are different. You can change the form but what you get out of it is always a function of culture.

**Katharina Pistor**

When you talk about institutional design you can't talk about cultural design in the same way. An example is central banks in the US and Europe. Central bankers in the US although independent are not really independent.

**Jun Fu**

When you use the word institutional design: one is static and the other is dynamic. We are moving in line with the US model. The lesson we learn from Eastern Europe and Russia has to do with speed. It takes a long time to build institutions and there is a gap in the process.

**Charles Sabel**

In the 80s, you had to have Japanese ideas of solidarity and there was a list of cultural differences that made it hard to converge.

**Chenggang Xu**

All the major reforms were in the decentralized way and then they were generalized in an experimental way. The question is then what is the mechanism of generalization. Reform produces new set of actors, which will oppose future incremental change. If this is true then it is not possible to generalize.

It is a sort of de-facto federalism in the sense that the central government is still there and still gives incentives, which will be there and will have regional competition. Once you have market competition, every firm has to survive and thus you might let go of some of the shareholders.

### **Katharina Pistor**

Regional competition doesn't show the whole picture. Going back to Eric's presentation, it is not only the outside anchor.

### **James Galbraith**

We have been working with two framing mechanisms, intelligent design and the other institutional ecology. A society develops its institutions in line with the existing other institutions and you incrementally tries to change. The idea of bringing a regime from the outside is likely to make more damage than improve the system. In the framework that we are mostly used to there is a trade-off between efficiency and equality.

The Chinese systems inequalities might be the source of inefficiencies. A distributional policy might allow for a more efficient outcome.

### **Patrick Bolton**

Why was there underreporting of GDP? This relates to regional governments. The regions that were growing fast had an incentive to underscore their performances because they wanted to avoid intervention.

### **Lawrence Lau**

On the manufacturing they have very good data but not on the services sector. Much of the revision has to do with the service sector.

### **Zhiyuan Cui**

The central government doesn't have a clear task. As long as they keep the personnel appointment they still have a lot of power in comparison with regional leaders. We should think of regional and central government as innovators. We shouldn't think of China as a federal system.

### **Joseph Stiglitz**

We are not outsiders looking at the evolution of institutions. All the policy makers are not only looking but are intervening.

The redesign of the communist party's institutional design has not been suggested but it is part of the ecology.

One thing I have noticed during my time in the Clinton Administration, there was a person in every department which played a critical role in making things work. It created a whole set of parallel networks and access to information which was not possible other wise.

### **Erik Berglof**

I wasn't trying to argue that this outside anchor was trying to establish a better system. If you look at what is happening at the core of the EU, the power of the outside anchor is weaker now.

Countries that have very few outside anchors available, such as Russia, to some extent uses WTO and the WTO is to a good anchor for resource rich countries. What it ended up with is a very strong vertical power but almost no strong horizontal one. This was reinforced by the taking over of the president of local governors. You can also see the connection of presidents to local leaders.

### **Jun Fu**

Institution in the western context is a way of levelling the field. This is not the case of China. What are Chinese characteristic. China is unique in one sense. We have a very large regional disparity but under a centralized state. Chinese culture always demands a strong leader because of strong competition among regions. There is no way to try to discipline leaders through an institution.

The game is unequal and you can't have a levelling ground. The question is how you can make small players compete with bigger ones. This issue in China is not like Eastern Europe where you want to return to the West. The Chinese population doesn't have the same ambition. The first priority for Chinese government is how to create jobs. If you think in the same way as the West then you would have to lay off around 60% of the workers and this is not a possibility.

Before 1970s, the Chinese built on the soviet model and invested in heavy industry but could not absorb the large surplus of labour.

Majority of people in China live in rural area. The western answer is urbanization. Even if Chinese markets flood the market you can still not create jobs for rural workers in the coastal cities. Their rural lives are much better than coastal ones and they want to go back. 150 million workers moved to coastal cities. The magnitude is huge. If we understand this issue we will have a better understanding of china.

### **Lan Xue**

In the last few years there have been reforms within the party system. There has been a change in the appointment of the party officials recently. The other change was conflict of interest.

### **Athar Hussain**

The category of federalism doesn't apply. A strategic view is much more important. It is the strategy of the central power to decentralize in order to achieve certain ends.

There is nothing in institutional ecology that dictates the presence of a level ground. Justice needs to be done. The iceberg principle: some people but not everyone get punished. The disciplinary of the party has not convinced the public that it is ready to fight corruption.

### **Xinghai Fang**

Some people have to be damaged for reform to move on. We can only make the majority of people happy by letting go of some.

## Property rights:

### Role of property rights / limitations on property rights / ideology & property rights

#### Joseph Stiglitz

A few general remarks about the role of property rights: property rights are man made with particular purposes. Much of the economics and law literature focuses on the impact of property rights in terms of efficiency. The legal system focuses on equity and rights. The economic and legal literature had a model mind. Often this ignored transaction costs. There is a multiplicity of rights –a bundle. How are these various rights assigned? You can own a property but how to sell it or use it might be restricted. There is a worry that if you gave the right to owner and sell a piece of land there will be events where you are forced to forfeit the land and develop a set of landless properties. This creates inefficiencies. Therefore giving more rights might end up in equilibrium, which is inefficient.

People always have rights. The property rights agenda is not an agenda of giving property rights but rather an agenda of clarifying the property rights and that process had redistribution elements. Many people thought they have these rights; therefore reducing ambiguity had a large redistributive impact. There may have been efficiency gains but the redistributive elements are more important.

#### Lawrence Lau

The owner of a certain property rights will receive a stream of benefits from those rights. Thus, property rights affect both the distribution of wealth and the distribution of income. The establishment of property rights is important not only because it affects the distributions of wealth and income, and control, but also because it affects economic behavior.

There was also a tendency in China for credit to go to a group collectively rather than to a small number of individuals. The most famous example is the synthesis of insulin by an institute of the Chinese Academy of Sciences in Shanghai. There is a traditional disdain on the part of Chinese intellectuals for manual labor (including operating one's own computer) and for money. While it is true that intellectuals are often not motivated by money. This does suggest a possible disconnect between theory and practice and provide an explanation for the relative difficulty of commercialization of intellectual property in China.

A well-established principle for Chinese economic reform is that it must be Pareto-improving, i.e., no one should be made worse off. In general, potential losers are compensated either directly or indirectly. For example, we have all heard of the rise in public demonstrations in China in recent years. Most of these demonstrations were against unfair taking of land by local authorities. But in Shenzhen, there has not been any problem despite the conversion of large tracts of land from agricultural to various urban uses. What Shenzhen has done is to provide adequate compensation to those whose land is to be taken. Each household is given two units from the redeveloped project, one to live in, and one to provide rental income to replace the lost agricultural income. Thus, no losers are created and hence no demonstrations.

### **Zhiyuan Cui**

We should not take US as the benchmark. Property rights are not getting even a principle of the reforms. Private ownership of land by Locks – should be a general right not a specific right. Locks believe that there is an ideological problem as not everyone has the property right. In China it is under consideration but due to this influence of the property right, most Chinese have to sign up rent contracts. Rental right legislation has to engage workers. Protect rights of everyone – Chinese farmers believed in rental law for 30 years and they were not ready to become an owner and pay land tax.

### **Discussion**

#### **Athar Hussain**

Property is larger than land, using a land example constraints discussion. We automatically assume that individual exposes to the collective ownership of land – periodic redistribution of land, corruption and losing priorities. Land disputes in China are more than issue of compensation, but conflict of interests.

There is a close connection between contract and property right. Do we need a formal contract? Even now in market economies lots of transactions are conducted in the rule of word.

#### **Patrick Bolton**

Coase theorem shows that Athar Hussain may be right. They are tragedy of the commons. If we are looking in the closed communities they can re-arrange rights efficiently – not over fishing – and no need for the proper contract. So Coase works for open communities when new comers are not aware of the rules.

Formal property rights - formalisation in respect to outsiders.

Coase theorem goes on transaction costs. Land is the only form of social security for the most of the rural population – no pension system and kinds may support, but land is a source of income.

### ***Property rights: the historical experience of the west & Property rights: the debate in China***

#### **David Kennedy**

From the point of view of legal framework, in every regime of property, there is a lot of sub regimes of obtaining and giving up rights regime (bankruptcy, taxation). In the law it is not clearly stated what you have and must do. There are all around regulations and there are tons of exemptions and cases. Details are the door away from the solid rule. These adjacent regimes are important, encouraging foreign investors, different holders which define efficiency and social productivity issues of corporate rights (real estate taxation – if some one is not using it at the effective rate). And there are extensions of marriage law and supporting those who were displaced.

Societal dimension of the property right obscures dimension of the choice for property rights.

Legal system – property has a logic. What do you do with two neighbours when one plays a loud music? Property is a combination of situation when you can exclude or you suffer from some one's action. And here we need economic and political design of the right – they don't teach this in the law schools. Implementation of the property rights needs engaging of those situations.

### **Anthony Ogus**

Political economy of the property rights is irrelevant to the Chinese situation.

Property rights has three concepts, private law of entitlements, and reinforce by individuals; role of the state to regulate for market failures; and regulations imposed for political or ideological reasons.

Western conception is conducive to China to some extent. Entitlements connected to the legal system may apply during disputes. There is certainty on decision of allocation risk and minimization of transaction costs.

How the regulatory environments deal with market failures? There is a need to ensure that there are no significant losers in the system.

Is an informal economy and making transaction is not a problem and not an obstacle? Competition can occur without competition law. How decision made by private actors? There is also a need to understand the notion of power, understanding private and public decision making and you cannot go around the high level of corruption.

Property rights establish the most profitable way of production but not the most efficient.

### **Carl Riskin**

There is weakness of rule of law in general. Land once was collectively owned in China. The Chinese dynamism, due to its gradualist and experimentalism: institutional setup is in the historical roots. Household responsibility system, incomplete formation of markets and fussy nature of the property rights, which is a response to economic and political constraints.

Validation of expropriation of the property rights is the key. Protection related to class system. Rights are better defined for the economic elite. Privatization took place in away of distributing to government officials and their family members.

### **Aziz Khan**

Chinese reforms are led by land reform incentives. At first there is no certainty if contracts will go beyond 5 years. The change from collective protection to private protection was very radical. Is it impediment to investment credit? Private market is a way to the economy of scale- all inefficient and small will die out and big and strong will survive. Needed investments will be provided.

There is huge inequality in the population in terms of sources of income. Wage income is not equalising and land income is equalising. Redistributing of the land constantly brought equality somehow, but not encouraged investments.

## Discussion

### David Kennedy

To Speed up consolidation so therefore local governments got huge amount of land, then to slow down state need the property rights. It seems like the Chinese government does both at the same time and this is not clear what intentions of the Chinese government are.

### Carl Riskin

Hundreds of thousands of acres of land were expropriated, and there were demonstrations and so on. Land belongs to the collectives and the expropriation starts by the local expropriating the collectives. That's the problem rather than private land ownership.

During the communist system private went to expropriation by centralizing schemes being undone by the Chinese government. Production teams shall be ineligible over theirs in the next years. Different levels of collectives fighting for resources control. The collectives are searching security to the systems. Relative equality income distribution is becoming a problem now.

Historical context is not due to 1988 regulation for government to appropriate land for construction. Individuals are bargaining with the land. Second is the social security value of land. Land labour is falling in China. People without land or having inadequate land will have problems. The gap in income in agricultural farming per head is 1/3 to 1/4 of the average income. The problem is not economies of scale. There are important institutional impediments for going from farming to not farming; to facilitate moving from people. Land tenure in this context is increasing disparity in China.

### Ping Chen

There is pro- privatizing for efficiency and investments in land in China. In the Southern area the original farmer became a landlord renting his land to farmers from poorest areas. The privatization encourages efficiency. There are also strong sentiments to stop corruption and tackle unemployment issues. With small farms that do not produce tax revenue it is difficult to take positive action on (corruption). Bigger farms can create tax revenues and clean governments. The only way to attract big business, as in Taiwan, is by tax break and tax concession. If governments can create industrial parks they create a virtuous circle. When privatizing land it is difficult for foreign investors dealing with small farmers. If there is not virtuous circle there is corruption. China's reform for any kind of measure needs cash flows or credits.

### Christine Wong

New institution was borrowed from the west. Local governments are interested in financing industrial parks and aggressively looking for land. National government fix acquisition of land at a very low level and land bank for attracting investment and borrowing money (not government but the legal entity) to build infrastructure. In the land issue it is not central government versus local government, but local government versus local people. This is a huge change and the government is worried.

### **Charles Sabel**

Not expecting privatisation of land anytime soon hearing all of these. This problem was central to development debates in 19<sup>th</sup> century Europe, flight of rural population to cities, known as manchesterism, solution was to build economies around the rural areas, familiar problem, example of Mexico shows that it is difficult to solve. David's idea, strong property rights, strong administration of the law. Whenever you see strong property rights, rights clash. Joe's example is an illustration of one "habitat conservation plan" to tell that strong property rights just to discover that the system goes back to what is already in place. More transparent administration is needed. Presence of one endangered owl stops development, now habitat conservation plan. You work under government auspices, you can kill an amount of owls with some specified compensation. The risk in china is that you have property rights everywhere except rural areas, but then everything goes back to as it was before.

### **Patrick Bolton**

There is one question not yet asked: what is the driving force for property rights? From macro perspective, rapid growth and rapid rise in incomes call for vehicles for savings. That is what is lacking at the macro level. Why is it so profitable to grab land, develop it and sell it, is because savings, etc... why is there such a real estate bubble? Because lack of savings vehicles.

### **James Galbraith**

What is the rational? What is the social mechanism for savings vehicles? Are they FDI, Chinese currency and speculative assets? What will happen if that all are owned and traded in speculative ways?

### **Patrick Bolton**

What is the return of Chinese household's savings? Massive foreign reserves are invested in US treasuries.

### **James Galbraith**

The savings of Chinese households that they set aside are not part of foreign reserves. These are function of FDI. People want real estate because speculative assets. Yes, they want that, but question is that it might have reduction of production.

### **Lawrence Lau**

I don't think that this is a problem. in the last couple of terms, Chinese citizens can invest in and overseas and actually greatly expanded their shares and also I think that this is neither here nor there.

### **Joseph Stiglitz**

I think that one of the issues that is behind this debate is the random income that comes from gains from the people that hold the land and eventually the overall land price is higher. The obvious solution of random income in the abstract is to have a capital gains' rate very high, to take the value of land back. That would not solve the problem but will be an interesting experience in the context of alliances.

one of the questions that is always difficult to solve for economists to solve is... random, part of the problem is that these individuals who hold the land want to make returns on the land, and there are chances for them to get the land, might be unfair,



might have capital gains tax and might tax away. I don't think that would solve the problem. In larger context, it is a little bit like, some experiments that someone did, on airline seats, they treat it like a property right, given randomly, they will go to war, think that it is outrageous that government would take back, creating inegalitarian society. They give stronger property rights to the commune and transfer rights of commune to the private developers and perhaps no transparency is better, because different wealth flows, because central government sees this as very transparent to society.

The guy owning the piece of land when the mall will be constructed will die for it. Giving property rights is not the solution, stronger common property will incentive private developers, if the process is done with transparency. Common property to property developers can generate more problems.

The central government sees the problem very downloaded to society. More security of property rights for commons will mitigate this source of unhappiness. Strengthen the individual may go the other effect. What is driving the agenda of the re-allocation process as a mixture of ideology and interests that this will gain from this broader agenda.

Role of uncertainty is bad for incentives? Actually, models, uncertainty can lead to more savings and investment, incentives are not clear. I think that underlying all of this is another agenda. Mixture of ideology and special interests, corporate sector, spillover and think that they will gain from this broader agenda, although rural side is only one piece of puzzle.

### **Katharina Pistor**

There is a need to explore alternative visions, clearly does not match what is happening. How China has faced 30 years of property rights to what is now? We don't hear enough about evolution of property rights in china, such as TVEs, some say they are like property rights, but need to look at different models. Ecological approach: how have they evolved over time? TVEs now are privatised. We can see the ideological entitlement debate, but can't see how china has come over last 30 years. This is an abstract debate, I don't think that we have understood enough about what is happening in china.

### **James Galbraith**

It was very clear that budget deficit in late 1970s, same as TVEs , because they were a burden to local governments, so privatise them.

### **Xiaobo Lu**

Current debate is about the land.

### **Francesco Saraceno**

To go back from land to more general issue, I think that the question is, as long the economy has high transactions costs, I don't think that the issue is not to solve property rights. It is more of an issue when the system evolves towards a more developed situation.

### **Katharina Pistor**

Still there is a model of legal rights of property rights which produced idealised outcome.

### **Chenggang Xu**

Basic facts – landownership is more open in China, no so taboo, so then you have debate. Secondly, changing hands of property rights, the assets of firms may be much larger than changing hands; China has experienced the largest scale of privatisation in a quiet way. Someone who visited china and commented ‘this is like church against Jesus’ you have to keep quiet, you pretend that Jesus is still there, in fact, big privatisation, almost all of the large, small, TVEs, medium firms, etc have already been privatised without almost no debate. Officers in state council responsible for stability say what does this means? What is special division of social stability position is? Once you have major dispute between owners, workers and managers, you buy them out, but this is secret, must be secret, because if known, disputes everywhere. But when dispute becomes very serious, this guy flies there and makes a big deal, i.e. one goes bankrupt, 20,000 employees, several thousand compensation, strike, workers surrounded municipal government building, armed police, this guy flew, strike deal. In Xi’an, every worker got almost 200,000 yuan compensation and his job becomes more and more difficult.

### **Lawrence Lau**

People are richer but they are insecure of the control of the assets or means of production. That is established in the Constitution and changes id do not pass. Private individual are worried and that discourages foreign investment. Clarification of ownership will help and is central, but different to land tenure.

### **Zhiyuan Cui**

While in the West the private property is protected, sacred, while in China it is an original sin. Even passing the law on property would regularize illegal property. People are ideologically pro private property rights. One professor wrote a letter during debate, if we pass this in constitution, we legitimise. TVEs become less profitable, after Asian Crisis, there could be other solutions. We could improve the TVEs, but instead, almost every sector is in trouble. Thus privatisation becomes solution and real democratic elections in villages happen. Vested interests lie in privatisation of land. We cannot avoid real political decision about what kind of society we want than we can.

### **Yingfang Zhang**

People in network with government officers make good use of unclarified property rights. Now they have goods and they want the money and push for institutions to be safe. Property rights are a major discussion for this.

## Corporate Governance

### The comparative dimension

#### Lessons from the transition economies

##### Erik Bergolf

We can look at experience of Russia and somewhere else on corporate governance. We want to take a broad view on corporate governance. We both include the governance of corporations and how it allocates assets within the firm, both human and physical capital; and also institutional building in emerging market economies. Corporate governance and political governance are very closely tied and increasingly so. Better corporate governance improves political governance and you see this in China.

A lot of the topics of corporate governance discussed in the west are not really relevant for emerging markets or transition economies. Corporate governance in transition economies where firms are typically SME that need to grow relying on bank finance, privately owned. A core problem in transition economies is the enforceability and the asymmetries of information. The challenge that we want to understand is why is capital not going to productive firms, given all of the productive opportunities, why is capital not moving?

Rapid concentration of ownership in central and Eastern Europe still continued. During second part of 1990s, although in Russia it has not reached the levels of concentration of Eastern Europe. In Russia, we also see quite notably improvements in corporate governance. In general, over the last 10 years more importance has been given to transparency and investor influence to enforce regulatory structure.

The governance of banks is credible. In Eastern Europe banks are dominated by foreign banks, whereas in Russia they are domestic. Banks' finance is important for corporate governance as well. In Eastern Europe bank's governance has improved because of the EU regulations but there are still many challenges.

But there are still many challenges facing these countries providing incentives to owners to entrepreneurial spirit, minority concerns, and etc. The large presence of foreign capital clashing with prevalence of populism is the cause of tension within these countries.

Russian firms do not have international and local credibility. The population is now in favor of state ownerships, although they wouldn't invest their capital in such firms. Where do they want to invest money? In Switzerland, they don't trust their own politicians to invest in infrastructure, so businesses are trying to, by listing abroad, bring in foreign board members, etc.

Finally, there is a fundamental mistrust between big business and government. Businesses are trying to increase their level of credibility. The big issue or core problem is the prevalence of oligarchy structures for defining property rights. When property rights are determined by oligarchies there are strong consequences.

## *Corporate governance in the context of globalization*

### **Katharina Pistor**

Studying corporate governance in the context of globalization, will there be convergence? According to law and finance literature, there are 6 indicators, but these are actually not true. For Chinese companies listed on the HK stock exchange, there are crisis, and bail out. We are looking opposite from Eric, by looking at outliers. It is a very difficult and complex system, once they break down, then gives a chance to figure out how it functions.

We studied the case of China aviation for understanding corporate governance in different regimes. China aviation was delisted and went into crisis. At one point crisis was big enough so that people started to speculate what was going on. Over the summer, it was still quiet. In fall, holding company did something such as process of insider trading to bail out. Under Singapore law, there is no need to disclose information. December 2004, China's aircraft did not disclose information to their partners. The CEO put 15% of the shares in the Singapore stock exchange without revealing it. Singapore's financial authority decided to hold their share in a negotiation package. In Singapore people were shocked by the details. The Singapore government says that we uphold our laws, even within international player, but they do in a way that does not antagonise China, given that large share of companies listed in Singapore are Chinese. Has Singapore been clean governance or not? Family connections in Singapore ask whether it is therefore crony capitalism? In China the holding company had to hide the operation to its investors. The question is: are we observing convergence of China to the exterior governance or are we learning its forms? Is China converging to the western models? Chinese firms apparently get a lot of exceptions.

When you look abroad you see more of that. Chinese firms listed on New York stock exchange, they get all sorts of leeway because of competition between New York and London. We need to look at bargaining. All sorts of investment banks are going to China and making deals just because of the size of China.

### *Discussion*

#### **Lawrence Lau**

Asks a question: I am a share holder, so, when something happened, then what? I am just a share holder, and I don't know whether it is better or worse. It is actually more to the deal. For instance, what is in it for NASDAQ, because NASDAQ got substantial allocations in China at a very good price. That is the over. But I think that the first question is the more interesting one whether to let them go bankrupt.

#### **Patrick Bolton**

Chinese shareholders transferred the monitoring to Singapore, which is trying to build a reputation with Chinese investors. On this issue, who is holding the shares? If it is the Chinese who are holding the shares, Singapore is building a reputation; it is perfectly rational for them to bail out.

#### **Lawrence Lau**

In this solution nobody lost. There was a lot of negotiation that may have negative externalities.

**Erik Berglof**

Larry, it is a good point. It was actually through Chinese journalists who bring more transparency.

**James Galbraith**

Is there a western model of governance? Shifting the costs back onto the Chinese?...  
Is this different in some fundamental way from that the Federal Reserve functions?

**Katharina Pistor**

No fundamental differences.

**Lawrence Lau**

We could argue that minority share holders came out much better than others.

**China's corporate governance challenges**

**Introduction**

**Patrick Bolton**

So, a lot of the points that I was going to mention have already been touched on. Corporate governance in China is an endless topic. I want to identify a set of problems. State-owned firms get 2/3 of all total credits; in spite they only generate 1/5 of the GDP. This may be considered a hidden subsidy.

The World Bank recommendation is to privatize in order to solve the problems. Eventually state-owned firms will be privatized but it will take time to get to the equilibrium. In the meantime, you can't rely on the Communist Party to improve governance. They appoint managers or shadow CEOs, the process might be improved by appointing younger, qualified and business trained people, or by banks. Local managers put pressure on local banks to get money and that is not healthy. An improvement would be a CEO more of a role in allocating subsidies through the banking system. There would be more control to central government but not as World Bank suggests of less control. Eventually the privatization will happen but a problem is the partial privatization, the number of firms in the stock exchange is growing, there's a decline in the value of index. What was driving this decline? The decline is because of the expectation that 2/3 of the rest of the state firms will be privatized, but this has not happened. Current share holders were concerned and government concerned with these issues and maybe should provide support. It is necessary to make explicit if full privatization is real, and to restore confidence by gradually getting a larger list of firms to privatization. Problem with Shenzhen and Shanghai is not that all firms are good, but there is a need to improve quality. Once you restore confidence, then you can get better. Now, there are perverse dynamics that only lemons go to Shenzhen and Shanghai.

## **Theoretical and institutional aspects**

### **Zhiyuan Cui**

The people's construction bank went to Hong Kong. Each corporation appoints a legal representative, not necessary a CEO. The legal representative is part of the problem. Private entrepreneur in China is lectured by a professor that is also the legal representative of a firm and also owns 100% of a firm that provides ice to the firm he legally represent. The legal representative is a problem for corporate governance in China.

One of the interesting proposals reallocate state shares into social security funds... construction bank went to HK, so this year, Chinese industrial commercial bank, listing in HK, but listing in HK does not prevent is later listing in HK, particularly Chinese institution, each corporation is a legal person, this person is the legal representative of this legal entity. This is a complicated issue in Chinese corporate law, he is the most controversial figure, and at least theoretically, he is.

### **Katharina Pistor**

Two years ago, Peter Wong gave speech, one private owner is like dictator of this fridge company, so he has been doing these things. Peter Wong, now this businessman is under attack, investigation. Why not loot my own company if I am the owner? Something was closed down and there were serious problems.

### **Lawrence Lau**

The financial laws are not being enforced and there are a lot of transactions that are not properly reported. Chinese stock markets a year ago had no good stock, but people in the market blocked knew the information. The qualified domestic investment institute to invest abroad was also blocked by these people.

Who ever is related, these laws are not really enforced, there are a lot of transactions, like Katharina shows, they are not fully disclosing when they are selling shares, but I think that the Chinese stock market will turn around. People in market resist and block new flotations, from 2004 2005, because they fear that shares go down if more supply, if you have money, you should be buying my stocks. A few months ago, something happened, shares could be listed domestically.

### **Xinghai Fang**

The professor is from Shanghai and all the people appearing in the TV has to speak standard mandarin. Too much debate, but nothing done. In the Shanghai Stock Exchange I have an office for financial services. My firm is related to 12 institutions belonging to the province and municipal governments of Shanghai. The CEO appointment belongs to my office, not to the 12 financial institutions that are owned by different entities owned by the government.

The situation of appointment and compensation: lack of long term compensation for these managers. Managers are compensated by cash, maybe for financial institutions compensating in the long term is more important.

Why the Party control these appointments? Because it is just established like that. The municipal government can give these appointments to people close to him. The board may be not happy with managers and still have to compensate them.

The Chinese government always wanted to maintain a lot of firms: telecom, energy, etc. Offices like mine control the appointments. The board can not fire the manager, but these guy's firms can. The board is elected by shareholders, in most of the cases the government.

The corporate governance in China has improved in the last five years. In the stock exchange firms have to disclose information. Now it is difficult. The stock exchange is supposed to punish firms not disclosing information, but they can affect careers. The stock exchange is controlled by the government, in order to promote corporate government; it should be independent from the State. Legal system is supposed to increase corporate government, but there is a weak legal capacity. The Supreme Court will only accept cases of investors if in another instance; regional for example, has made a decision. The legal system has to be improved.

**Charles Sabel**

Legal experts have given up to the idea that stakeholders control will lead to better corporate governance. Can the gatekeeper exercise control over corporate governance?

**Xinghai Fang**

Few of the people appointed are related to the Party officials. The transition has led to a change and the financial sector is getting more competitive, with better governance. Up to date the financial sector monopolistic, but that's not longer the case. There is problem between ownership, appointment and compensation. Managers have a short term view.

**Charles Sabel**

Comparing the USA and the China systems they seem very similar.

**Xinghai Fang**

Some firms are still controlled by the state. The trend is towards more private, for better performance. In the insurance sector, a firm is with majority of private stakeholders. In the appointment process many people try to exert influence. The whole process is convoluted and not transparent.

**Anthony Ogus**

It seems Chinese firms seem to what is known in Europe as public firms, where the internal management and compensation schemes proved to be a disaster in the 1960s. It is just a state in the development of firms.

**James Galbraith**

I want to come back to some questions. A good theory of the firm needs to account of the fundamental fact: most successful agglomeration of manufacturing industries in the world in penetrating other markets. How come is this most successful than India? It is not trivial to produce with the quality and reliability world markets require. What is going to happen is that firms are maximizing something else, something successful for the country. It is necessary to take into account how Chinese banks behave and whether the discipline is provided by the banks or by the world markets. National reform in context: the problem of governance.

Looking for differences in quality, selling in China, the quality is not comparable to export firms. The orientation to foreign market is something.

**Aziz Khan**

For every 3 dollars of exports, imports are 80 cents. How to explain surplus?

**Lawrence Lau**

Exports to get foreign exchange were the case in the old days. Now people want money in China, over-importing. It will be legal to transfer dollars abroad.

**Ping Chen**

Is corporate governance an important issue for China of just for the USA after ENRON? What's the role of financial markets in firms? Corporate governance became an issue as a by-product of the agent-principal issue. In China the rural reform is leading to industry and joint ventures. For TV industry a family own the company, no much of the agent-principal issue. Right now, Chinese are competing for strong management. State-owned firms are in problems, they play the game of the survival. Large monopolies such as state-owned firms are a problem and the country faces a choice: to let them compete or to privatize them first. To break the monopoly and let the firms compete is more important than privatizing. Creating another agent to monitor CEOs is not possible now because the board of directors has incentives to do a good job.

The increasing inequalities in education and health care are the main preoccupations. Giant state assets universities, and now the need to behave like American professors. The Chinese government mentality faces a lot of issues at a time. Not only corporate governance but local governments that behave like a corporation and own hospitals, companies and a lot of assets and have a lot of benefits. They also have incentives to borrow a lot of debt that will be paid by the central government.

Dilemma: local governments are not allowed to have deficits; local governments can not go bankrupt. The governance issue for 5-10 years is not critical for companies apart from giants. The dilemma is to privatize the American way or to introduce a democracy system to introduce more transparency.

Every government faces competition from the private sector. If they don't pay competitive wages, all go to the private sector. The government has a standardized wages system. Now that they compete with private sector accountability and transparency are not issues.

**Christine Wong**

The issue is what the government does and what the government is.

**Ping Chen**

The financial market is very difficult to manage. The firm may increase its profits and then will be rewarded by the financial markets. The problem in China is that everybody wants to get a share of that! There are coordination issues to make companies very profitable. When squeezing profits they have an incentive to share



profits. Therefore they create a chain reaction in the government that has to see another form of revenue such as land appreciation.

### **Akbar Noman**

Corporate governance is important in China. In financial sectors moral hazard and agent-principal problems are very important. Chang, kicking away the ladder, central banks are accepted. Now the debate is about the function of central bank. Nexus about financing institutions and the possibility of bad behaviours that leads bad managers to behave badly. The problem is not corporate governance but creating incentives for managers. Corporate governance problem: bad managers' behaviours not solved. Going beyond, even if the problem is solved or not, it is not enough argument. How to minimize the cost of moral hazard? This is not solved either. Real question: cost of moral hazard vs. reducing macroeconomic performance. The question is the macroeconomic impact of financial crisis important for the design of financial markets regulation.

### **Joseph Stiglitz**

Corporate governance is important! Problem: managers don't control the assets. Since there are not broader definitions and there are three sets of problems:

- 1) Abusive: the managers and majorities steal from minorities;
- 2) The owners and the managers and majority of stakeholders deprive the rests of firms by borrowing;
- 3) The managers steal money of the majority.

The agent-principal problem is reinforced by public good problem. No country has solved the corporate governance problem. Financial market competition does not provide an optimal solution. The scope for doing bad would be limited. The problem is that insurance companies take money now and don't pay it back later; there is a broad scope for misbehaviour. There is also a strong role for government intervention. Monitoring is a public good and has to involve the public sector. The more inter-temporal the structure is, the more opportunity for misbehaviour.

In the last 10 years the USA take ideas of the literature, the notion of EPO has always been accepted but can reach levels of magnitude where it is theft.

To have good infrastructure is a problem in China and most emerging markets, it implies going back to the marshallian solution of occurring firms. Doing better in corporate governance front is important.

There are three major strategies:

- 1) To minimize the scope of the conflict of interests, practices that have given rise to corporate sources of conflict of interests;
- 2) Flexible legal framework to attack new conflicts of interests, i.e. innovativeness of private sectors for that. China meeting March 2006: Reformers CEOs. Martin Act deals with corporate governance and the behaviour is controlled by the Attorney General. China is not to have this law. So it is a good piece of legislation.

3) Systems of multiple checks and balances, especially checks. The broader institutional framework should be built on how this multiple checks play out.

Financial systems relying in bank finance provides incentives for bank to monitor. Corporate structures with large stakeholders (individuals) have incentives to monitor.

Debate in the USA: Do intermediaries effective check? For example, in Eastern Europe 1991-1992 in the Czech Republic, a holding company agglomerated the vouchers and monitored the companies. They run out with the money. The question is: who is going to monitor the monitor?

The bottom line: the World Bank view that capital markets provide a solution is wrong. Need of a comprehensive agenda of corporate management. This is important for China to raise capital from their own people. Russia: privatize and liberalize the capital markets facilitated stealing money in Russia and keeping it safe in the USA. China should move stronger to corporate governance rules.

### **Lawrence Lau**

Serious companies/family firms, most of them have a dominant family shareholder that increase the monitoring (internalize the monitoring). A complete diffusion of stakeholders implies that nobody is going to monitor.

An example of corporate governance is HSBC where the chairman got 2 million pounds per year. His total retirement is 4 million pounds. The right people is with the right values.

### **Joseph Stiglitz**

Family owned firms are an example of bad corporate governance. How was the privatization of the TUES?

### **Chenggang Xu**

Today the companies are not owned by political leaders, they are owned by managers that got money from different schemes: borrowing from private money or banks. Most of bank loans' problems are associated with state owned firms.

### **Christine Wong**

The debts of the TUES are from before the privatization times.

### **Chenggang Xu**

It is similarly for the privatization of small firms. 1/3 of the firms were sold to the employees, managers own more shares.

### **James Galbraith**

How an organization is run and how is protected from misbehaviour.

### **Zhiyuan Cui**

The government is pushing for privatization. Introduce the issue of equality in the privatization process!

Aug 9<sup>th</sup>, 2006

## More Discussion

### Joseph Stiglitz

Let me just show you some of my thoughts and get your reaction and think of the end of discussion today. I thought useful at this moment of making an overall revision of the discussion and its direction. We have varied task forces that have been involved approaching problems from different perspectives, thinking about ideas, broadening the discussion. In general our view is on clarifying the debate and the argument than finding solutions. We are not looking for templates to fill in, is very much trying to focus and shake the debate. For example in the macro economic task forces was mentioned how the discussion was excessively focused on price stability whereas we want to pose other questions such as the nature of economic models, expand the debate and change by identifying the problem shaped the answers. We had the vision that IMF focusing on price stability was wrong. Clearly the way to frame the problem has been wrong; therefore clarifying the questions will have a significant effect on the economic debate.

In this case, we are discussing the development of legal frameworks, policy frameworks and building institutions. The question is, is there any room for a multidisciplinary country-group something that could contribute to that debate? In this particular case, academics engaging in this type of debates are very useful if you want to think in case study type of debate. So it can become something that can be important for a teaching perspective, as case study will help to test the theory in light of the evidence. One of the difficulties everyone here would like to maximize the policy impact in China -whatever that means- but one of the problems people has been discussing what are the debates going in China and where this group can engage? One of the problems of any society is not always clear what is going on, we told the example of the compensation, of the people whose property has been taken away, is a very interesting discussion, a transition without losers? If you could go around and identify all the losers we will solve all the economic problems. But we do not have the information to take such approaches. Secrecy or lack of transparency is one of the instruments of achieving growth without losers. I saw an article yesterday where every hour there is a new protest in China going on is one inherent problem, the nature of the Chinese transition is one that would not be transparent. Hard to understand how it works.

If you use the word party as we use it in the American way is an institution, is often very difficult for outsiders to understand how such institutions function.

There is also a disagreement in a society where things are changing very rapidly what do you mean by market with Chinese characteristics?

Privatization at this stage has been systematically avoided.

And is part of the ambiguity where we are stand China is not the only place where this has been avoided. For example Bolivia they invent "capitalisation" that now has the same meaning, and of course de-capitalisation sounds terrible. How words can change

the meaning of what we are talking about? The “plan” now is referred as “blueprint”. The way of changing the language is indicative of the change that is going on, that might delude, so what are the problems for those who do not speak Chinese at all?

Let me go back a little bit to the nature of the project. Most of the task forces results had come with a book, with an attempt to articulate several ideas. With a couple of exceptions, we do not try to reach any consensus among us, but rather a semi-coherent discussion. One person might actually challenge each other, but is divided in chapters, is neither to be comprehensive, we try to identify where are the key issues, most of the books, we have been publishing by Oxford University Press and Columbia University Press they have been very well received

So one of the outputs of this activity can be a book, one of the things that we can put there is what are the views that we have addressed about institutional design, how do we think about this issues, trying to make it not just abstract but context based in China’s evolution in the selection of topics: poverty, institutions, intellectual property. The most specific, the more possibilities to write a paper or write a debate, to say, here is the worry about, here is where China's economy is different, some views of what would be a good competition law, or a view where is no needed competition law, that is the view that we might articulate, the absence of institutions such as intellectual property is another discussion, competition is another when we put it in a framework we have to think what are the other part of the package that become. We should think in a paper about land, rural land, and property rights.

That is one output that we can talk about, my original conception was, each of this chapters or parts will be more better off if we pair with someone of China and someone of the west. In one hand the ones who know how is the debate in China and others who know where are the debates from the point of view of the West. Part of my concern is that the nature of the debate as it has been led by other institutions such as UN, WB, has been partial, there is a whole agenda, there is an ideological agenda that interacts with other ideological agenda, so the notion is that this can serve to open up the debate but is important to articulate it together to bring different notions, different perspectives. That is to be decided, it does not have to be the same way for every topic, it can be depending the complexity of the topic on the other thing to be discussed is the design of the course, where we are trying to talk about this ideas and think about a way for the students to understand this issues that have been raised. A third one, we have to think if the results we can have a debate in Beijing with policy makers, I find a great openness to open with a range of issues, a remarkable openness to listen, both those the advocates of pay as you go, and the others with more academic approach. It was very clear the different worries, it was a different discussion. We had a discussion about competition law and intellectual property; I do not think it will be difficult to bring a discussion with senior political officials so that it is good to know to the think in their minds.

### **Katharina Pistor**

I was reflecting that there is a mismatch on the room of what are the issues. It is not clear what the issues are how the debates are framed in the Chinese context? I know that was discussed yesterday how we frame, where everyone “knows” how we are discussing but we do not know how the issues are debated in China, to me is that sense or even alternative ones that have not been taken in the table.

**Lawrence Lau**

I think it is true that you can reach symmetrically to get transparency, but in a more macro level the solution is to make it uniform, the enterprises that are entering in bankruptcy will get some particular treatment that actually might be better if you think about this compensation, the non transparent compensation, I think that will be in use, the cost in society will be less.

**Joseph Stiglitz**

If you are going in that direction, what are the frameworks that you have to solve that problem?

**Charles Sabel**

Can I reflect something about that? I think Joe's position is quite accurate if you want to go to the institutional rule, people gain the rule and everyone becomes a loser, compensation is an issue also in the west. You have to do something. Social services are trying to divide new services to customise the services, so one is the orientation of the welfare state but this is more customising based on particular context. I do not know if it is happening in China, but it will be difficult to discuss if we do not take in consideration this shift.

**Lawrence Lau**

We had a discussion on the compensation issue, (example of the examination) based on the score. You can argue that is not efficient system because you are taking one example, one exam as the only opportunity but for the fact that is perceived as incorruptible is better. I am arguing against customisation.

**Charles Sabel**

The problem is when people do not perceive the rule as fair. Give example arguing difference in language I am fascinated by the case that if there is in China a way of systematising the experimentation of reform. There is complex sense that the Communist party and its residence if it is allowed to manage a process of experimentation. I have ever seen something rather of common experimentation in China where it describes the stage. That is an example of a class of new institution. This is kind of my proposal, if see there are Chinese scholars that want to work on that.

**Joseph Stiglitz**

Is there a sense of some of you are engaging with the discussion in China, even academics giving a generic view to the ones that are looking from the window looking in. They can give us a sense of how we might be doing it, how are we doing it, where we can engage. Even in general or in a specific sense.

I think there are indeed different debates, at east there are two, one more conceptual going to the nature of the issue, and the other is more trying to go to the issue of the pay off. Is already quite clear what is the issue, how do we solve the issue? Borrowing the solution from different countries? The Western experiences are generally very helpful, so will be quite common to get in China discussion of such frameworks, but in this room we are acknowledging that the historical context and the evolution of

institutional framework, then it might be leading to other problems, then we have to observe the state of art, the bench mark, how can we get to that level? I think in both parts of the debate, we can make a contribution to that debate, just from yesterday's discussion. I think before leaving this room today.

One is the context of the debate, where we know we are debating the conceptual issue or the trade off. The other issue is that we have to come with a common structure, we probably need to address the structure of the paper, and where are the key parts and what are the discussions there? The third thing is if we can have other discussion topic in mind that we should address in this meeting or other.

That was my question and my comment.

**Lan Xue**

We know, maybe there are some issues that are related, but we have to define it.

**Joseph Stiglitz**

In the program it was not in our idea to solve all the issues it was more like to discuss where are the other issues, not the answers, such as Federalism that Christine put in the table, it will be both answering another way of framing, the whole social agenda. We did not take it on, not because was not important, just because might belong to a different group, but maybe we can expand it. I think we know enough to think it like where are the issues debated and make a plan not as a plan but just as a guideline of the issues. What are the issues that we have not taking off?

**James Galbraith**

We can discuss property right in a context free environment or we can discuss it in a context specific. Let's say China. We need to decide at what level these issues will be framed. The second issue is the coverage of this particular project, the project of the task force is institutional design, is that a limiting concept? Does it include institutional redesign for example of fiscal elements of the state, include institutional design.

**Katharina Pistor**

Can you give us a sense of the priorities?

Just would like to know if this will be discussed, we need to make choices and make a selection focusing on property rights and governance, but there are other great numbers of things of greater needed attention if we take it in the specific Chinese context.

**Joseph Stiglitz**

Can we have some one form China view?

**Chenggang Xu**

I consider federalism is an issue. How central powers control the sources and talking about institution we have to face this, what kind of institutions should we introduce to other insisting wherever new thing has to be faced on this will take away central power? Are we suggesting redistributing it? One example is the juridical system, if taken, can be independent of the regional power? That is one of the issues faced in

China. When we are talking on firms, they still aligned with regional power in the other hand experimentation in reforms; apparently we talk of semi autonomous regions, so there are trade offs.

**Xiaobo Lu**

Central local relations, is precisely about what? Because the issue is so big, and it has political implications, what is the control of Beijing in the local when we talk about institutions and when it has to be talked about Constitution?

**Christine Wong**

It is also an issue of public administration and governance.

**Lan Xue**

If you talk about public servers there are 2 million people. It is difficult to talk about the central government. It is also difficult for them to address the problems even if you want to talk of compensation policy that is paying?

**Joseph Stiglitz**

It was very clear that was the critical issue, major impediment to establish a good security system that will facilitate the movement internal the country but it has a budgetary impact.

**Lawrence Lau**

We should not discuss about centralism vs localism because there is a point where centralism is desirable (gives an example). So a single unifying national policy is good if you decentralise it, just cannot be done. So we have to think if it is a concept that we want to push. Same with the security system definitely is something that is necessary I think, the direction is looking at every problem carefully for if it has to be centralised or decentralised, for example as for large districts, a district would include more than one state, so district would be immune to influence of state. We push successfully a couple years ago that was reversed. So we have to think if that is to be pushed given local power fiscal power, can we think in China as 33 states?

**James Galbraith**

So in your view if China gets states (such as US) will be more federalism or less federalism?

**Charles Sabel**

EU engaged in the debate of federalism is the more misleading discussion of the central and local units. Are we turning into a form of encouraging this kind of experimentation? Not to try to decide domain by domain, but have some explorations, saying explicit, federalism is bad word for the phenomena.

**Joseph Stiglitz**

We have a task force on decentralisation and one of the discussion so far is that decentralisation is actually –to think is a positive way, pointing how WB has been pushing decentralisation too far. How can we think different on this?

**Christine Wong**

Vertical and horizontal, which level of government should be doing this? In the horizontal division, there is a consensus that there are far too many levels. Municipal, rural, the issue is whether this is the right number of levels.

### **Xinghai Fang**

Indications that the party is concerning redesign training course for senior policy officials - the core forces, more theoretical, combined with practical experiences, senior and party organisation to identify the core areas to work in institutional design: environment, NGOs, education, social security, capital market. For that course, we invite 5 ministers, because they are in the front line and their views to combine with the more theoretical issues. The other part is that from the experience that we had from these training courses was the presentation, even when we have the identification we have to think in how to present these stories in the Chinese mind set you start with the theory and then the practice, but in the Chinese case is practice, theory, and practice. Those presentations you start with the problem, you give different way to address the problem, let say the American, the British, and so on, so you mention about. I will suggest that one book contains the theoretical arguments, let say more conceptual and , the other more issue areas, to me the chances is bigger for official to read the empirical way, but of course they might be interested in theoretical ones too.

### **David Kennedy**

One way of thinking in the debate on China, at least in the west is a very broad debate, even talking of institutional that is a mistake, is like to imagine we have a blank slide where we can start. But we actually should start with what is already, already there is a form of decentralisation, a form of firm, a form of there is an innovation system, a way of capturing institutionalisation. So the question is how can we enter into the debate of what is going on, with a start that what is going there is more than an unfortunate context, but a very creative way of institutional elements to start with our intervention; a second view if it is true that western experiences are truly relevant, we can offer an exchange, there are some characteristics gaps of the understanding, in the systematic errors on our own institutional approach presenting our institutional design system as historic specific as yours, isn't the kind of project of intelligent design, there is a systematic underestimation of informal and public management that we are not discussing or viewing. There is an over estimation of formality and autonomous private sector, misunderstanding of the forms that result from this, the idea that form is a device for transparency or form leads to administration, those are characteristics that to think seems gaps, but can be a special contribution if you are interested in the last thing would be the unity of our system is often overestimated, is not in fact that we have a core federal, one of our characteristic is that we are plural, at any moment the discussion can come up with another example is the European argument to unify, but in England we do not have an unified position. We become comfortable in our variety of ways, but that is not visible for externals, if our experience is relevant, understanding our system. Often overlooked, it seems the dialogue should not be in the level of theory or practice, but something in between, where the Chinese colleges can identify difficulties and strengths. So we can combine middle level that can be useful.

### **Xinghai Fang**



What are the most important things if you try to address something that is very big, it might be possible not to see any change, not to say they are not important, but would have no change or impact, for example the federal local debate. Another example is the issue of the land, but I do not think the government is ready to have any big change, so when we choose to address these issues we might choose the issues where we have a chance to change, at this time for example the use of law, the first thing is the civil service in China in the process of establishing that system, China is quite different from other countries. Second issue: dependence of the central bank, is it useful to be independent? What are the appropriate institutions that we should address for offering solution? Third issue: antitrust retail, Chinese judicial system they always look at the centre, but China is too big, so if you can talk in the Chinese system that would allowed some innovation. Financial services require from Beijing for all the instructions and that delay decision in the rest of the country. I feel there is a need for judicial innovations at the local level, can we discuss about that? Those are the four things that come to my mind, the important and the ones that we can debate.

### **Ping Chen**

Different approaches, each one reach their satisfaction, other approach from China experience, institutional evolution under the context of global competition and ecological constrain, there might be another way to think about from my understanding of development. The issue is technology and development, if you think if from US is different, but from China is different perspective, there is some many technology which one is the good, what is the actual with your context to solve this problem. We need to know which technology and where is your market and your target, and this issue is so pressing. I talk to corporate leaders from local to provincial to central and it is an issue for them. Then coming second issue for example textile, electronics, is this going to continue to growth? How to move out at the technological level is an important issue to be discussed, if you can count for direct investments. They are growing to fields that already are taken off not the underdeveloped ones if you want to increase internal accumulation; you have to think in a virtual cycle. For this, Eastern Europe have more chance than China but they did a wrong move, if you want to attract foreign direct investment you have to invest in infrastructure, and governments reform, then institution matters at this stage, however, institutional arrangement are not unique (gives an example) very beginning of China reform, because the cultural revolution by centralise strategic position, with is a position for peaceful time, separation of party and governance, this is very much related to corporate governance. China after 10 years goes in a circle, we are decentralising again, but is not by rationality and it is by reality, the rise and the form of the region not depends on your geography or environmental issues but in your leadership, good leadership but bad institutional design that constrain, bad for the country. Identify dependence, selection of leadership is far more important that establish corporate governance that constraints. Second issue, after decade of development of regional paradigms, regional integration, beyond the scope of the politics, of decentralisation I think that is an issue to be discussed in an approach (not political, not economic) Can we merge 3 regions as a competitive region? In other level, there is a serious debate of industrial policy for regions with great natural resources, poor because geography. Huge investment in infrastructure because strong opposition from coastal area. Why? If Sichuan becomes an industrialised area, Chinese ecological disaster will be more severe. Then you come to the issues, how can we solve the issue? If you follow the US model, federal transfer to compensate, I already tell you it would be difficult to

collect tax, and is not competitive to maximise profit. China is a system regime, for example Sichuan has high deforestation, so X (second region) buys their rights to preserve their ecological goods. Is regional cooperation and new rural movements need economy scale they are looking for .Netherlands model, South Korea model, etc, to develop a cooperative, not such a large scale such as US, but 1000 specialised in some product, such as fruit, tourism, increase and sustain. IPR what is the ideal size. Economic integration should be driven from the top or the bottom? If no competitive leaders, it does not work to build a new stage, longer perspective, what is the future of partnership could go? To change the concept of property right, corporate governance, etc. At this stage of coastal area no leadership would agree of privatize the land, for demographic regions however inland area you have, if you privatize and reforest can be long term economic growth. And I think Chinese culture and Chinese tradition need to be put into consideration,

## **Intellectual Property Rights**

### **David Kennedy**

Could we use this discussion as a way of modelling --- thinking in the result?

It has been a design as a dialogue between Chinese and western.

Innovation system of the model, there are forms for protecting and sharing innovation what are the forms and what are the perceivable problems which give some sense of the underestimated elements of our own innovation system when they look back to our IP system.

### **a. The debate in China today**

#### **Lan Xue**

I will talk about three things: Chinese innovation system, general context of the recent debate and few words of the question on debate. The Chinese innovation system if you think in the 50s have been very much after the Russian model, training people on university and taken them in the Chinese university. This system has worked quite well for some research orientation, kind of atomic bomb, hydrogen bomb, other but for industrial innovation has been not that good, we need other types of institutions. In 1985, there was a reform and the focus was on research institutes, later on universities, to provide incentives to work with private initiative, the idea was to cut funding to force jump into the sea, at the same time work with the national science foundation. That has been the formula since 1985. In the late 1990s the reform was further advance when research institutes have been asked to become independent enterprises, so the structural reform pushes them to become enterprises themselves, so there are 600 institutes that went to the market. That is a brief description of the process.

The general context of the recent debate: in 2003 China made an effort on science and technology development, the state counsellor was still involved in the effort, the focus where was different, such as national innovation system, service industry, armaments issues and so on, legislation and protection where also there, early this year China held the biggest conference in science and technology and proclaimed 2020 innovation year, independent innovation or self innovation or indigenous innovation. Major players where there, and the focus was away from universities and institutes and more focused on private initiative.

There are other mayor issues: economic development and production, international pressures, if we really want to become innovative country, from the intellectual regime, how to balance between indigenous innovation and technology transfer? Some people consider Chinese economic development need to have a new face of this dichotomy. Barriers are that multinational protect indigenous innovations. There are also efforts of multinational to bring innovation to local firms. China needs to provide incentives to generate ITS. Recently universities and research institutes use patent as indicator in the promotion decisions, lots of patents but not use many of them, so how do you give the right incentive? How to access to intellectual property protection? What should be the system in china, horizontally rely in different agencies, covering different things, brand name ones, patenting others. Conflict of policies: how to make it consistent for different regimes. Vertically, does the central-local issue IP

administrate local government and has great influence on behaviours; what are approaches: legal-contractual, governmental? How to improve patent system?

**b. The economic and legal debate in the west**

**Joseph Stiglitz**

I will talk about four points: 1) First the model sold and bought; 2) true economic analysis; 3) true institutional analysis; 4) correct policy prescription. 1) The centre of innovation is the centre of enterprise. Foreign firms with intellectual content to be part of the global innovation system IPRs strength is the solution. The true economic analysis is that intellectual property rights create a monopoly that in general is bad, in knowledge is particular bad, because the cost is zero, so is a artificial scarcity that leads to misallocation of resources, the only reason to do it is that will lead to more innovation, that is what the debate promote innovation to overcome the cost. The argumentation that the IPR is not promoting innovation, it increases the cost of the most important input: the production of more knowledge, if you have zero transition cost world, you can imagine in practice it does. Secondly, the problem of what is called the fact those overlapping patents that make almost impossible to engage in innovation, i.e. development of airplane, that required litigation for patents, just solved for the first world war made clear the need from the US to reach that technology. Right now there are thousands of application of IPR in software, that is acting as an impediment for innovation. The overlapping of patterns is causing a negative effect because you have monopoly power. For example, Microsoft has an aversive effect on innovation, because new ideas know that ideas will be still and the damage cannot be undone. So everyone knows that innovation will be absorbed and you will not be able to capture the benefits. There are ambiguous effects in promoting innovation. Strong critique is focused on unbounded excessively strong regulation. True institutional analysis says that in fact, there are key issues in implementation of intellectual property that are ignored and not being picked up, let's say the debate in China and in other development countries that are affecting the policy debate and that should inform the policy debate in such countries. IPR regimes in US have changed dramatically in the last 20 years, so benchmarking against the US now, 20 years ago or 20 years from now. Where are the forces changing the game? Corporate interest has had an important rule in the case of the state to address users, consumers, producers. But that balance would be working for example for China? If they are going to imitate the benchmark of 20 years ago, they need to pay attention on distortions. There are at least three areas that changes are going on, very important in defining what you mean on what can be patent, the extent and scope of the patent, and 100 years ago molecule could not be patent, the extreme is that now you can patent a gene. What about a fraction of the gene? Is that innovation to be patented? In the case of chemical what we use to patent was the process to get the chemical, but the evolution is now, the result in the most extreme case. Issues are for the scope, for example: car is four wheels vehicle. Could it be patent? Novelty standards, related to indigenous knowledge, are just because it is not published in an American journal is not knowledge. For example, Indian knowledge was patented in the US. At the same time, US recognise that can be abuses of monopoly power in patent. You can have a monopoly right but you cannot use it. As for public use, there is limited use by paying licence. In US the software industry is worried of excess of intellectual property, internationally the view is that those who where advocating do not understand IPR at all. The understanding is poor and they are negotiating the international spheres and

are the one going to China to negotiate. There is a consensus among economists and lawyers that we are going too far, but the ITCR? Those dealing with China are representing other interests such as Microsoft, etc. So the case of TRIPS that is a very bad negotiation, scope, novelty and coverage has an enormous amount of discretion. They will continue to hit you but never win a case; they will not bring it to WTO.

### Discussion

#### David Kennedy

There is a kind of gap between the two styles presented.

#### Lan Xue

I think the debate takes that as a given fundamental issue of that if the regime is good or not.

#### David Kennedy

Focus on the key parts of the regime and collective solutions to these problems. Whereas is an administrative solution, legal protection increases our knowledge

#### Zhiyuan Cui

In China the understanding is very primitive, when people talks with IPR. Symbolic act that the Chinese president visited Bill Gates, since Microsoft made important lobby on China, they pay software engineers. Two years ago they have published a public document that Linux is not a good technology. Our understanding of IPR is not at this level, so understanding the regime of IPR is critical.

#### Lan Xue

In general, Chinese innovation has been developed very badly. Over the last 30 years, the first 25 years, incremental state owned enterprises are more interested. In recent years, increasing more innovative approaches the frontier, they are indeed pushing for better protection of the IPR, the issue are not only multinational. The government understanding is relative simplistic. The efforts should go on to give more protection but also in protection, patent infraction, piracy. Fundamental issue is that is taken as a given so how to push it.

#### Charles Sabel

Coming back to the discussion, we can tell the harder the rights, the harder the administrative solution and contractual arrangements. In telecoms and IT there is a massive move towards, people systematic treating as a shift co-develop, Mini linuxes, mini open source. That's an answer rather than think about. Free spaces for innovation, protect from patent tolls, right to worry about it, would be surprise if you can have this discussion.

Second point of discussion, you have China focusing on competitiveness, the key on competitiveness moving up on provider chain co-development capacity by consumer and the supplier. The consumer insists the supplier has the capacity for co development. At the same time they enter by the pool they belong, they are forced for co-development. Sometimes there are patents other than no, the point here is not irrelevant or just part of a package, but there is a counter force that has to be described as much as the force in itself.

### **Pin Chen**

Examples, negative impact of intellectual policy is the monopoly of profits could be too high. Why they exist in the US. In 80s almost everyone used pirate software, what is the solution. Microsoft realise they needed to have differential prices. Student, professor buy Microsoft software, but the market in the price is different. Deals for example Taiwan publishers what is the reason of a price, right price depends on income, even for low income they have the right. Price is too high. In US cost two hours minimum wage, but in China the same price is two weeks, so this encourages other alternatives.

The other side of the story, US define that market leader set the prices. In china it is changing because low development stage, government permit piracy because it creates jobs, but moving to a different stage of development, we start protecting. Intellectual property right becomes better if global competition becomes more plural not just few players.

### **Lawrence Lau**

You cannot go for innovation without intellectual property rights (Example of Taiwan), what are the boundaries of the property rights. What can be patentable? Molecules, the process to synthesise or the product itself, we need more research to debate. China, traditional medicine, is it patentable? I think one of the reasons that China is pushing is the added value. Licences encourage people to become honest. Text books in the Indian and the Japanese case. There are various ways to create conditions to become honest rather that force people to pay the price.

### **Carl Riskin**

My primitive understanding is the design is not only to create monopoly but to make knowledge public. In the application of the patent, there need a description. So the question might be put in terms of the balance.

### **Joseph Stiglitz**

Software that information is not disclosed.

### **Carl Riskin**

More of the radical discussions have influenced the debate in China, when the case is actually not happening they will like to know the case.

### **James Galbraith**

Giving China's position what is the cost of defining the regime, what is the cost of resisting cooperation?

### **Joseph Stiglitz**

Sanctions

### **James Galbraith**

OK. On the economic merits, if there is no sanction there would be a cost. Taking the issue of honest society, materially what price do you pay? I think there is no strong case. It seems like it is more international pressure but not necessary of national interest.

**Paul Wang**

Years ago in 90s Chinese refuse to change IPR law because of comparative advantage, but now the leadership have made clear that IPR is necessary. The core issue there is a change of policy issue of standards. It is an important case in china for foreign companies. Why Chinese people rush red light?

**James Galbraith**

There is not cost if there is not victim.

**Paul Wang**

The reason is that if they do not rush they feel stupid.

**Aziz Khan**

We have not argued too much about WTO rules and future negotiations in relation to the topic.

**Lan Xue**

Not to talk is because of the cost of enforcement. It has been 10 years on trying to enforce the IPR protection, but indeed is the same for food and drug administration, environment, etc. facing lots of challenges at a local government level. Need to be brought into consideration for discussion in developing countries. I think China has not done too much in analysing the cost and benefits of the current regime that has not been done. I think people is taking it as a face “we are encouraging IPR and innovation”, and the other group think that multinationals are taking the indigenous innovation with them, but there is a gap that I think is where this group could contribute.

**Joseph Stiglitz**

In the WTO framework there is much more room to use the discretion to use the IPR regime than actually a standard observation. It says that you have to have a minimum scheme but no more. To much extent, IPR is about bargain, China has to get in that dynamic. Flexibility too is part of that bargain approach. Example: Brazil and the US drug makers. They announce compulsory licences, particularly interested in AIDS drug. What happen? US made statements and US companies agreed that would produce it for 10% more than the price fixed for Brazil. China could get in the same regime. But they might not want to get into that. It clearly can be a treat.

**Lawrence Lau**

India is also doing that.

**Joseph Stiglitz**

Of course, it is not possible to apply that strategy in the context of Botswana, but in a larger country related to innovation system. Specific mechanisms are designed to improve technological innovation process system as incentive; government then has the patent to offer for that who can become a player. Within China it could distribute the medicine at a marginal cost. This is a far better way to provide incentives particularly for drugs that require social innovations, other issue interaction between standards and innovation. The case of third generation and Chinese standards, people think it will be an error to have a different system for the rest of the world, but in the

other hand it could create a standard, considering the huge demand and how large is the market. So it can be possible. The key is bargaining. We do not set a standard but get free access to your standard.



## **Competition Policy**

### **a. Key issues in the debate in advanced industrial countries**

#### **Joseph Stiglitz**

I will start talking about the broad theoretical issues. There have been slight debates that market are self enforcing, so do not worry about competition policy. Without barriers or entry governments do not have a role anymore. No one believes entirely this anymore. To which extent is competition law a law that companies use for competition and to which extent this law helps the market work. Conservative basis let the advantages from a large scale and the sufficient natural checks, in the other had what repeatedly happens is the use of law to beat an effective competitor. So right now the number two chip maker is soaring the first one, so is not about competition law is about using the framework for benefits. (At least that is the Intel argument).

The period of 1980s to 1990s have been influenced by Chicago economics, and made it into the law. In one very important issue, predatory pricing, means you lower you price to have a monopoly and then put it high when you have it. The argument is that theoretically is possible but the government would not permit it. Even when clear empirical cases, the reference of the Supreme Court basically said you haven't met that standard, and in the US would be almost impossible to have a predatory price case. The argument is that we need a stronger competition policy in a context of global network. We have a multiplicity of enforcement institutions and you have both civil and criminal jurisdiction. For companies set abroad in addition are the international jurisdiction, my view is that is a good thing when Microsoft used the budgetary power, that is the good think but there is also a cost of political cost of society of having monopolies. For others perspective is good.

#### **David Kennedy**

Seems the debate is based in a different dimension. In Brussels is being discussed defining the scope, the standards etc to make diverse jurisdictions work, so that requires to know the specific regimes, for example the Chinese etc. It might be an already degree of competition or regulation as a part of industrial policy, so is not that there is not competition law, what is making the existing players in a variety of markets in China and what are the problems that that regime is facing.

#### **Jun Fu**

1987 was the year 10 years after economic reform. Here competition policy was used interchangeable. The discussion was if we would imply a law against unfair practice, the period coincides with mushrooming of small companies in Province. In 1997 monopoly law was proposed in the agenda, but was postponed until this year, this year the state council is in agreement on the draft by the Ministry of Commerce, preliminary review on the MPC. If we are looking at an area of competition started in 1987, it has been more than 10 years.

Principle contents of the law as subject of preliminary review by MPC have 56 articles, preamble and covers 3 areas of monopoly. It deals with it both horizontal and vertical, it also talks about abuse of intellectual property right, market concentration, emerges and competition, issues with authorities, covers ministry monopoly, state owned enterprises, interstate commerce. Although in China there

applies a different model, organisation of jurisdiction, there is debate about this one. Penalties, sanctions, the third thing I will talk about are debates. Debate are about institutional ecology, why has taken so long to come with the draft, and why at this time, has to do with the chapter on the administrative monopoly, something very unique in China, whether or not that chapter has to be part of the law. They advocates from two sides, idealist says Chinese economic reform has to move from a planning system to a market system, to break monopolies such as telecom; the realist considers, why has been taking so long? Monopoly in particular is resisting forces and there are interest groups advocating. Unless you redesign Constitution there is little room for institution under the state council to rule against. If you put it under the law you will have a law but not applicable. Other area of debates is organisations of jurisdiction, involved in the area of competition and modernise, in the central area, Ministry of Commerce involved in. Industry and trade and unfair proactive, the law probably will come with a state hazard condition, how to deal with the organisation which needs to be a untied commission under the state council to begin and as part of administration to create a law enforcement under the state council. There are also other technical areas where we can see debates, if we look at the history of the US; the system was dominant by intellectual school. Harvard school start analysing with a structural sense, it seems to me if you look at the debate in China, it is idealistic approach which do not look at the structure. We do not have very sophisticate stuff; do we have the power to apply? Restructuring or rule of reason, Chinese would like the last but require a level of expertise. Chinese is looking at pharmaceutical firm, conceivable a drug from health, merges and acquisition, arguments from different areas, not to be used too high, lot of mergers and adjusting that are not registered. To summarise, we have all sorts of debates in terms of debates, technical aspects and law.

### **Xinghai Fang**

As a Comment, I think looking at the driving forces of this particular law and also IPR, one argument market itself will develop its own system, but is not particularly ideal, is clearly interest, players and industry itself that do not want anyone get in. Also bureaucratic interest, same things happen, who gets what. Two or three institutions have already had power, what will Ministry of Commerce do? Who is going to be the leader institutions on this law? There is an interest power, and interest plays more important role in the puzzle.

### **David Kennedy**

This raises the question who is promoting regulatory competition.

### **Jun Fu**

I give cases of what are the driving forces of the competition agenda, agriculture, automobile, commercial airplane. Perfect competition is ideal, the issue is what is proper competition, China tries to set industrial policy to set that, but China already had 100 companies doing cars. Open to multinational even when introducing China price is high so no benefit for the internal market. Why it is supported? They are more competitive if you are the major company there. Very important events change peoples' mindsets. A group of producers organise to sue multinational firms, if we produce DVD players, intellectual property rights law is related to competition law. Multinational companies are easier to bribe central government. Central government are pro-market but not local government because they have other interests, which is not a homogeneous nationalist government.

### **David Kennedy**

Competition regimes, what is in China is for, the regime in US was for creating particular openness and for particular sectors, in EU was an attitude beyond balance, it was specific kinds of consolidation and openness cross borders. The council was on your right because that was the agenda, same if you wanted to build a leader competitor against US firm. But prior in European industry is beyond the general interest of the equilibrium. What is the interest then in case of china? Consolidate in a particular region? Open or restrict.

### **Chengang Xu**

There are internal interests originally. There was a battle between ministries. Federal ministries are against each other too.

### **James Galbraith**

Clear the issue is those sectors which have strong mono politic structure: transportation. To what extent foreign monopoly, how do you deal with their use of that paradise? Socialist economy: perfect competitive environment?

### **Lawrence Lau**

Chinese Enterprise uses the monopoly before the reform, so it is only after the reform where they had free price setting. Second issue, took too much attention in monopoly if you are really thinking in competition, break in and still you will have monopoly. The other example is the petroleum company. No intention of senior level to break in with that monopoly,

### **James Galbraith**

But you still have a benefit.

### **Lawrence Lau**

Most firms love to be monopolies if they are given a chance, and they agree in everything they can, if you really want to realise benefits of market system, market is good, if you are close to perfect competition, otherwise not good at all. Market system creates the conditions that actually help.

### **Charles Sabel**

As people discover the limits of the Chicago School monopoly, platform domination, operative system, everything you can have it. Everywhere this is a massive shift, determine the effort to find new ready for platform abusers contrary point to Chicago school. If you have that in the background creating spaces for new platforms, same as local governments, the changes of stabilisation is zero (related to Chicago school).

China is debating to come or not with a piece of law. Three sense of players, monopolies, domestic monopolies, this certain players have to against propagation of monopolies, smaller domestic players, they are for, consumers as well, on balance entry of multinational is what brings the case of the monopoly law. This explains why have been taken so long in this particular moment.

### **Lawrence Lau**

These are monopolies run by ministries where the law would not apply. In some sense the monopoly can be implemented but will apply to the market subjects not to the ministries in it. Control over ministry monopoly.

**David Kennedy**

Competition of both public and private enterprises

**Paul Wang**

Lawmakers have not though truly blocked transitions, by the Ministry of Commerce. I think the lawmakers block energy sector, not allowing foreign acquisition.

**Joseph Stiglitz**

The complexity of competition policy is so greatly heated debate in US on telecoms where we do not have a government monopoly but multiple regulators, debate whether we should have them. Same argument: one group, market will solve it, second, the sector will be undertaken. What we did not understand was the relation highlight there are different systems, and have in mind such differences, if we adopt a system that is not useful for the whole system would not work. Issue of why is coming up now after reform? Monopolies did not mater before, as structure of economy change, these issues become paramount, you do not want to go for a system for a government that can't control everything to a market that control everything. Political power of large enterprises, in this case, it is of the party. Scope for multiple agencies, special interests, exercising influence, concentration of power becomes important, wasn't the recognition that was a market failure, political power that true attention. Think in the economics and politics in the process; How this will lead to the evolution of the market economy; One of the reasons to have a strong competition law is because it becomes the centre of this particular context of the economic policy; As China continues to be part of the global economy, external pressures will have on it, US government; we have interest here is the benefit of our companies, almost part of industrial policy.

## **Law, Regulation and Enforcement**

### **a. Legal and Regulatory Institutions**

#### **Lawrence Lau**

Who is the monitor of monitors? Hong Kong independent commission against corruption, basically observe, special prosecutor not looking into any particular case. Analogy of organisations is like this. In China there is nothing like this but there is the tradition. Chinese tradition goes to the centre to solve the local. There is also a tradition of collective regulation. Legal system evolves in the American style system? Issue of civil law can be reconciling one is common law, civil law and the one we want to do. What happen in trading with UK and Europe might be a way to work out, is not new system should allowed citizens immune to central government.

#### **Xiaobo Lu**

Talk about regulatory and legal institutions paper itself talk analogy, new game, market economy, role of the state is changing from Coase, player and referee and now will have another state as a player in the game. Private sector is something new and oldest pre-existing agency contracts, government look at the contracts. Once this SEC local branches is at the mercy of local governments, because they are local players. Increasingly it becomes a problem?

1998 State Drug Administration, spillover of other regulations, third way on reform enhance the existing administrative relative power, no longer the ministry itself, they are policymakers and regulatory bodies; the fourth one is completely new agencies, commissions, such as the State Administration Production System challenges one of the biggest, is not they do not trust the state but they do not trust society either, perhaps even more state than society. The problem society do not rely in itself state cannot be small; there is no third sector such as consumer organisation. No trust in social organisation such as consumer organisations, etc. Consumer does not trust other than the state, call it culture or institutional people do no trust other than the state, so that increase state power. But regulatory cost is tremendous, not only from investor side but government itself.

#### **Chenggang Xu**

We all know that before the reform, during the cultural revolution just in the light of 1970s have been thought the importance of legal institutions trough the reform, in our nationwide survey was how important where the legal institutions, they use written contact, 90% firm more than 80% they have written contract. If any problem does they use court? 11 to 12% would pursue legal procedures. 60% of the firms regionally support for winning the case. At the very beginning they try to develop the old system, because of that got serious problems, people from military when retired. Discussions are not allowed to challenge any administrative procedure of law, right to challenge the government so is kind of irony, 1989, implementation of this law was delay, and become relevant until late 1990s. From 1990s to 2004 there are more than one million cases and 700,000 cases from 2000 to 2004 given incomplete definition of administrative permit. Basic point to make is that perhaps there is a good idea to design a citizen, interest groups and give then tools to fight with the government.

### **b. The experience of the west**

### **Anthony Ogus**

Three key areas of facing institutional design in western experience 1) government; 2) regulators and regulated industry; 3) reinforcement. You just cannot give a simple model but appreciate the diversity of Western experience. On one hand you have the regulator agency in the sense of autonomous like US regulator commissions, then you turn to what is called social regulation, dealing with distributional issues, semi regulating or part of departments, then there is other legal accountability. The second relation regulators with regulated, command and control model, the agency is the role maker to a model of co-regulation, where industry also is part of the design, government or state agency do not have the information to do a meaningful regulation, allowed industry to provide their own rule, aside that we can link with what Larry said early if that opens the way, might not be appropriate for Chinese case. The third case, insufficient complies if relying on only one systems or regulation, monitoring is already expensive. If the probability is low firms will not care, therefore a growing use of sanctions can be applied, third parties and victim enforcement.

### **Discussion**

#### **Ping Chen**

Diversity for differential thinking rules vs discretion, moral judgement discretion implies possibility for corruption. Law is more clear governments? I would say no different standards of corruption or fairness. Set outside legal framework. Bribe the law makers, difficult to adopt American system, the whole issue of TRIPS, huge transaction costs.

#### **David Kennedy**

What is the right mixture of public and private, formal and informal elements? It is difficult to figure out what exactly we want to add to the debate like the heterogeneity.

#### **Christine Wong**

I will talk about regulation and regulatory form in China. So far the reform has been driving by external pressure, the strategic training. The reform undertaken so far is lack of strategic planning, regulatory planning etc. The problem here is whether China should adopt a single practice or could be transferred to China reality? Is whether if it can be transferable. To the regulatory official what should and could be assessed is that in China one way of designing regulatory reform, the focus is economic efficiency, issues of consumers are ignored, objectives have not paid in consideration. Social objectives have to be taken into account.

#### **Charles Sabel**

I would like to come back to the point of rule and discretion of centralisation decentralisation, formalism, informalism, and the classical dichotomies. Efforts to solve it can derive on ideology. Idea that is always the same is wrong; Illusion that can be truly solved is dangerous. The question is there are new forms to establish that accountability? What you see in EU organisation, very highly developed forms, you see new forms of accountability, present their evidence, not the old formal procedure, radical different counter process with new form, this lead to discussion I want to put that on the agenda.

**Katharina Pistor**

The case of share, government system solve information asymmetry problems, my question after listening to you, if China lack of law, asymmetric information, reinforcement should go much broader, not necessary one.

**David Kennedy**

Spilt rather than hurry up? That is a fundamental questions, whether China has to go to all the stages that other cases are proven or if can jump to the best practice level. I am allergic to the idea of best practice model, the discussion so far. When we add a cultural dimension to that, people does not merge as a new. There is another dimension: human capital and investment in human capital in order to invest.

**Paul Wang**

There is too much discretion to China official. For example, it takes 20 years a process but if you pay it, it can be quicker. The reason why they can do it is discretion.

**James Galbraith**

You can have a scientific approach to assess regulatory system. When not understand of corporative frauds, because where designed to be complex enough to not being perceived by regulators. There are fewer economists but more Criminologists.

**Paul Wang**

China is lack of independence of the regulatory system and party leader is part of judicial system. In US court it is independent. In China as for monitoring systems but they are system by the party, practices that not actually legal take away people in not disclose locations.

**Lawrence Lau**

Improve in the regulatory process; same with bank.

**Carl Riskin**

Chinese side talks very much of impact on interest in regulatory forms. Small enterprises out of the monopoly and the western discussion are mostly theoretical one. What I am not hearing is political economy regulatory system, current administration. Chinese colleagues right of tell us get real, I would like some how more political economy on the outcome of this debate.

## Next Steps

### Joseph Stiglitz

Think in the important issues left out, priorities, form and contents to discuss after a break.

### James Galbraith

I can make a list of the issues we are discussing so far: Other issues:

1. Fiscal Control – central vs. local / extra budget finance / civil service / regional cooperation
2. Social Stability – social security pension / health / unemployment / inequality
3. Development – education / energy / infrastructure / environment / technology
4. International – trade / exchange rate / capital flow / resource supply / scarcity
5. Credit – central bank / banking system / finance and capital markets

### Paul Wang

Debates in China: supervisor court, do not exist in US model but the German one. Border Supervisors like quality, financial knowledge, not qualified mainly are workers. Other reason, CEO is most important person, if CEO chair then the supervisor does not have real effect. Because this defects of the system, some scholars have purpose to give corporation right to chose independent actors, otherwise many monitors. One view says company should have the choice, another view says, China system should go with just one style American or German. The new cooperative law brings such issue also independent directors, unlike the American model in China only requires 1/3<sup>rd</sup>. But they might face the same problem than supervisors: lack of experience and lack of influence. Perhaps something possible to borrow from the American model is the independent session shareholders and its role, shareholders just introduced in China, looking forward to have more. China Corporation has duty of social responsibility, those debates where in the 80s trying to do that legally and make it enforced. For example contribution for Charities, but in China the law does not require that. Conclusions, it can be used for defences, or monitoring defences, my proposal is let the market solve the issue, potential for regulatory reforms, strength the power of shareholders, give a company a choice of supervisors or monitors, otherwise too many supervisors.

### Lan Xue

I think somehow we talk of some of them and some not. How can we link these issues to the institutional design perspective. If we go as these issues, we have powerful reasons to select them but hard to choose. Can we pick some of these, to go trough them?

### David Kennedy

Pick some issues almost at random and try to innovate in the way the conversation has gone, with a particular the context of reform, there are other issues. What we can learn from this kind of conversation and the way in which, outsiders can interrogate and understand the Chinese experience and how a culture interested in this moment in institutional design can dialogue with outsiders? We are facing the need of a methodological innovation, to pick examples and perhaps interests.



### **James Galbraith**

The idea was not just to bring broad list of issues but is more about five categories. It is more about to choose what we can discuss in the further work of task forces.

### **Joseph Stiglitz**

We have not mentioned the issue of importing and harmonising models and the internal problem that this led, in the globalized economy it seems the path but this is to bring home issues that would merge in the local law.

### **Katharina Pistor**

I would't overemphasise that, I think the country still having enough position to make the choices

### **Yingfang Zhang**

Government policy is implemented by local policy. Staying on the theme of institutional design we can look back to the planned economy and at different sectors. Public sectors units have not even been touched through these years of reform. Most of them are hospitals, cultural institutions, partially founded by government. When the government faces fiscal crisis by the middle 80's, expenditures would be reduced and so all services with partial exemptions where closed. At the local government this was not implemented same thing with child services difficult to preserve public funding for public goods. The government is on the issue of reforming public issues, for example, but there are imperfections where individuals make the most of the benefits Literature goes on and on, difficult to talk of extra budgetary terms, tiny fraction of what stands. The amount of the proportion comes back who is monitor of the monitor? What is the government possible to rule? These are fees collected by governments. Although they can do in the budged side, they cannot go into wild. Land banking has been done by local governments everywhere. Inland side they were not very interested.

### **Charles Sabel**

We cannot research this in old way.

### **Joseph Stiglitz**

I agree with you, thinking about the frames will be useful to think on the discussions that have been made. There are two aspects of that, there is agreement of meta models that are not probably ideal, and there are room for new ones focusing on ecology, dynamic systems, etc. One are what are the sets of discussion of those, the other is what is the content that will build the strength, I mean specific issues, or something that we can discuss about because is something that we know. Maybe we need to highlight the key aspects. There was an issue made earlier who are we writing for, who are the readers, who we want to affect? There is a sense that at this level it is more academic exercises trying to interact with policy makers.

### **Katharina Pistor**

Can we do this with a practical significance? The way you frame it will be the challenge to offering (or not) a solution. Make it significant to China case.

### **Lawrence Lau**

I think other approach can be case specific, for example taking the case of Microsoft, how it has responded with other competition regulatory frameworks such as US, EU. This are things that can be useful, what is it happening in other context in other countries? We can actually generate more useful elements, based on what people has done and how can we make it relevant to the Chinese experience. Will be difficult if we have a very general approach, but capture the specific. We can start analysing a specific case emerging public input into policy issues such as this case. Because public debate on these issues no matter they are private or not, it will impact on rules. We go deeply into what we have universal general knowledge.

**David Kennedy**

Specific country, we are trying to invent a method here to address the particular projects but with dynamic reforming problems. We have an opportunity to say something in this moment not only to say something about the Chinese policy, but we have even larger model. In discussing the case of Chinese context, we are trying to challenge colleagues already working on this, address the good performance and import regimes affecting the already existed.

**Joseph Stiglitz**

Areas more discretionary aspect of institutionalisation, strengthen in the formal may lead to more informal. That is maybe a lesson to bear in mind when we do institutional analysis.

**Ping Chen**

Large pressure to back to the welfare state model: healthcare, social tax, etc. We miss to discuss more directly issues of corruption. Scope for this generation of leaders, they are engineers, not constrained for conceptual debates, and they minimise political risk unless something else happen. Crises are good; they are fuel for institutional reform, however in China it is used to scare the people.

**David Kennedy**

Why these issues were chosen?

**Joseph Stiglitz**

In part, for contrast. The American model is not to be followed but seems we are hurrying to do that.

**David Kennedy**

To take the US for applying or criticising, you need to put it in contrast with other. In that case is possible.

**Christine Wong**

Again who is our audience? I would like better to address Chinese policymakers and for that we need from our Chinese colleagues to suggest what the topics to be chosen are.

**Joseph Stiglitz**

We are arguing the process of creating capital market we need to use institutional frameworks for that.

**Paul Wang**

It depends on how you frame the discussion.

**Charles Sabel**

I think a lot of the high tech work is not coming from capital market, but once firms start to move more aggressive with innovation and acquisition abroad, there are other issues that would be necessary to take off.

**Zhiyuan Cui**

Not only address to policy makers or IMF, but also for educational problems. Issues are for educational propose for general public, to understand cases.

**James Galbraith**

Economic information

**Carl Riskin**

Not linked empirical with intellectual cohesiveness, how to do it, not necessarily China is learning from but they are happening beyond.

**Joseph Stiglitz**

Other debates would be focused on political economy and interest groups, influence on how they are affected in affecting institutional analysis, does anyone has in view of how to address it in our book.

**David Kennedy**

I think they are interrelated to the structure we have been discussed, but the agenda did not approach the US model as a experience

**Charles Sabel**

These things are continuous, we do not put it aside but we put in the present.

**Joseph Stiglitz**

I think there is an important scope for contributions.

**Lan Xue**

Intellectuals along with policy makers and institutions come along. Interests groups come to the discussion. The current state is a much more fluid for the policy debate.

**Joseph Stiglitz**

It would be extremely useful if you send a list of papers of what would you like to write about, names of conceptions of topics, structures and who might be helpful for filling the gaps, some of them they could not make it. We can change, add or include new topics. It will be good if you communicate that too. To get a sense of how you see this evolving, as we originally conceive knowledge of what is going on have people inside better than the outsiders. We would like to have it as joint papers. Can we make a blog about it?

**David Kennedy**

Perhaps a more traditional approach (by mail)

**Joseph Stiglitz**

The important think is that we would like to have a diverse of visions on it. The tasks force and its work should make it more interesting and more difficult. Greetings!  
Thanks!