

CASE STUDIES IN
CHINA'S INSTITUTIONAL
CHANGE

中国制度变迁的
案例研究

(第三集)

执行主编 张曙光



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张曙光，经济学教授。男，生于1939年9月8日，陕西长安人。现在是中国社会科学院经济研究所研究员，中国社会科学院研究生院教授、博士生导师，北京天则经济研究所所长、中国区域科学协会常务理事，深圳综合开发研究院理事，西北大学、中山大学、浙江大学、南开大学经济研究所兼职教授，北京大学法律经济学研究中心主任。

1959—1963年在西北大学经济系学习，1963—1966年在中国科学院经济研究所读硕士研究生，1966年毕业留所做研究工作。1979年评定为助理研究员，1983—1984年借调国务院经济研究中心工作，1985年晋升为副研究员，1988年破格晋升为研究员，1993年被国务院学位委员会评聘为博士研究生导师。

主要研究领域：宏观经济理论和政策、制度和制度变迁理论。曾参与“六五”经验总结，“七五”国力预测，“八五”改革大思路，2000年的中国、中国以及深圳和海南发展战略，中国宏观经济管理等重大课题的研究；亲自主持了体制变革中的宏观经济稳定、中国社会科学院宏观经济学科、中国贸易保护代价的测算等重大课题，做出了多方面的理论创新。从1977年开始在报刊上发表文章，到目前为止，共发表论文400多篇，出版著作20多部，英俄文译著5部（篇）。

主要代表作有：《经济结构和经济效果》（中国社会科学出版社1982年版）、《公有制宏观经济理论大纲》（副主笔）（上海三联书店1990年版）、《中国制度变迁的案例研究》（执行主编）（第1集）（上海人民出版社1996年版）（第2集）（中国财政经济出版社1999年版）、《张曙光经济学书评集》（中国财政经济出版社1999年版）、“Measuring the Costs of Protection in China”（American Institute for International Economics, 1998）、《中国贸易保护代价的测算》（合作）（美国国际经济研究所出版）、《繁荣的必由之路》（经济学随笔集）（广东经济出版社1996年版）、《中国经济学和经济学家》（四川人民出版社1999年版）、《制度、主体、行为——传统社会主义经济学反思》（中国财政经济出版社1999年版）、《中国宏观经济分析报告》（主编）（第1、2集）（社会科学文献出版社1999年版、2002年版）、《市场化与宏观稳定》（主编）（社会科学文献出版社2002年版）。曾四次获孙冶方经济学论文奖和著作奖，一次获国家科技进步软科学一等奖，两次获中国社会科学院优秀科研成果一等奖和二等奖，享受国务院颁发的政府津贴。

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Foreword to the Third Volume^①

Zhang Shuguang, Unirule Institute of Economics

Evolving Institutions: Informality and Interaction

In accordance with our original plan, this volume was intended to focus on the studies of the relationship between informal and formal institutions, around which the process of transition in domestic institutions would be laid out. Over the period of implementation, however, we found many ready-made researches that were in line with our objective. Some would, instead, be selected in the volume. Amongst them is the study conducted by Chen Jianbo that has set forth a quite specific discussion in this aspect. Here, I would like to have some more words over a couple of issues raised in his work.

Under the framework of institutional economics, it is, recognisably, important to address the issue of relationship between informal and formal institutions. Yet, that does not imply that one can afford to leave out the issue of their interactions over the evolving

① The text is a translated version of the article written by Prof. Zhang Shuguang as the foreword to the third volume of *Case Studies on China's Institutional Transition*. To avoid of certain complication, all references attached will be referred back to the original paper done in Chinese.

process. In fact, it is more of importance in depicting and explaining what actually took place in the transition. Amongst the existing researches, however, much of resource has been laid on the former, with the latter, more or less, being left in the cold. In this regard, the evolutionary school of thought have made some headway, and events of the real world would also help, as they provide some much-needed input that can be reflected upon in this area of researches. And that may underscore the significance of case studies, for they actually delve directly into the socio-economic institutions, what is called the "humanly constructed reality".

That said, Chen's case has taken into consideration the point in question. For the purpose of providing an explanation over the change in institutional set-up taken place in Township and Village Enterprises (or TVEs) and of a rapid accumulative increase in their assets, three questions are put forward with their corresponding responses. One is concerned about the existence of innovators possible. In other words, how could entrepreneurs possibly be created in the old system? The second is how opportunities could be discovered. Specifically, where does incentive come from and how is the mechanism formed? The last one is about how to obtain those factors of production necessary and subsequently put them together with some sort of contracts. The responses to these three questions have brought about the fact that informal contracts, or "institution" in the jargon of theory, have become part of solution.

In respect of the first response, the existence of innovators entails conditions of both being eligible in accordance with administrative guideline for governmental officials - the formal institution, and of

having lived up to the status of township crackerjacks or smart guys – the informal institution. Similarly, if, as with the second response that has been taken concurrently with the third one, opportunities so spotted rely heavily upon the relationship of blood – ties and locality, then putting them together in some organised way will certainly require the support of authorities in the form of official approvals. Indeed, the entire process presents a complicated multi – centric and multi – lateral contracting arrangement in both formal and informal fashions.

From there, Chen brings forward a different argument as to the notion of efficiency in the regime of property rights. In his words, there is no such a thing as an absolute efficiency in any society or economy if void of such factors as existing institutions, ideologies, traditions, histories and so on. Nor is there any absolutely efficient regime of property rights without taking into consideration those factors.

For long, Economics of Property Rights has been preoccupied by those classical issues of carving up the “share” between firms and markets, while grossly ignored has been those efficiency improving contracts of various kinds that actually lend themselves to different stages of market development. These contracts, although shy of market norms, incomplete in excludability, and even not properly traded, are serving the end of bringing in higher efficiency than did the old regime. As such, it has been argued that the benchmark of appraisal for institutional reform in transitional economies should lie in the state of efficiency improvement, bearing in mind that every contract so produced has to be set in the context of the prevailing in-

stitutional arrangement.

That aside, the case has made available some new ideas concerning the relationship between formal and informal institutions and their interactions over the process of transition. In the book, *Institutions, Players, and Behaviour*, I have, in terms of formation of the two and their interaction, presented some generalised comparison, that is, they are different in tangibility, coercibility, costs of implementation, time taken in formation, and source of knowledge (1999). Although still in shape, they could be elaborated further in light of the ideas rendered by Chen's case.

First of all, since institutions are something created for the purpose of regulating and constraining individuals' behaviour, they can thus be in-built as well as exogenously imposed. In this regard, all informal institutions, as they are basically formed out of individuals' habits and thinking patterns, could be seen as in-built, whereas formal ones would be imposed externally, given they are normally obtained via the process of public choice of some kind.

Furthermore, as long ago as 1996, I differentiated institutions in terms of being nominal and actual in their effectiveness. In view of Chen's case, such a differentiation could only be applicable to formal institutions, since informal ones are always effective due to their in-built nature that goes with human behaviour. In fact, the very existence of nominal property is just because of the activities of informal institutions that, from time to time, annul the efficacy of their formal counterparts over the process of their interaction.

Given informal institutions take shape, by and large, out of individuals' habits and thinking patterns, in addition, their growth

path would reflect an evolving process of gradual accumulation and continuousness. In contrast, the progress of formal institutions is rather discontinuous and ad hoc in nature, whose formation could possibly be discerned in both time and space.

Finally, the two institutions are continuously interactive over the process of transition. In other words, many formal institutions have grown out of their informal equals, as some group habits, regularities, and the like gradually become institutionalised by the rule of law or certain decree of authorities. On the other hand, many informal institutions are shifting or shaped up under the pressure of formally established institutions.

In short, it is not difficult to see that, under the condition of gradually evolving society, informal institutions normally precede formal ones. Not only is the formation of formal institutions, for all practical purposes, modelled upon their informal counterparts, but also the vitality and adaptability rely heavily on the degree to which formal institutions inherit from and are compatible with them. Nonetheless, formal institutions in their manner of coming into being are not always conformative. By relaxing the condition, they could possibly be set up in their own rights, which, in turn, would reshape the existing informal institutions, so long as they go along with perceived human nature.

Reform: Top - down and Bottom - up

Over the period of on - going market - based - reform, some changes in the existing institutions have been initiated and guided by the authorities, while others brought about spontaneously by indi-

viduals or enterprises. Among the cases selected, the study of property - rights reform in those small and medium sized SOEs in the city of Zhuchen, Shandong province can be seen as a typical example of the former. And that of trade in the right to use in public housing by Longdu Real Estate in the city of Tianjin would embody the latter. The two kinds of reform serve their respective purposes and, subsequently, have different effects.

In Zhuchen's case, the reform was, well and truly, a result of government's hands - on policy - from reform's design and target to implementation and actual operation, the local government played a quite indispensable role. The rationale behind the direct involvement of the local government, as the author put it, was that it would not be possible for the reform to move ahead in the absence of active participation on the part of the local government who was, effectively, the owner of those SOEs. Moreover, as one of keys to the success of reform lies in redefining the functions of government, it became essential, goes the argument, for such an involvement, not least because it would sort out all those entangled obligations that beset the relationship between the local government and the SOEs.

Right or wrong aside, there is at least one thing for sure, that is, it is certainly not a rare phenomenon throughout the reform - a widespread financing practice of the so - called "closed loan", for instance, has come into existence under the prod of the government. In fact, there have been a couple of more generally perceived factors at play. One is that the size of government, though smaller due to the reform, is too large and its tentacles reach too wide the

sphere. As such, it becomes almost unthinkable to induce any change without the resolve and the power of the government.

The other factor would probably be concerned about the so - called "maximisation of bureaucratic utility". In a transitional society, like that in China, the most ideal, or profitable, project for the players, in the enterprise of government has to be the reform in whatever establishments of an old regime. Hence, it would be no surprise to see officials, high and low, jostle with one another to scramble as much the chunk of large deals as their stamina permits. Indeed, it may well serve as a pretty good explanation to the incident of twice reforms in the event taken place in the city of Zhuchen.

Nonetheless, it would be a mistake to overestimate the value of the direct involvement of the government. In terms of making a breakthrough under the circumstances of stalemate and of loosening its grip over the markets, the government has conceivably played a pivotal role. When it comes to other areas of the reform, however, it has, more often than not, served as anything but a drag. And this has, indeed, underscored the author's argument of "smaller government" and "role shifting amongst major players".

Specifically, the role shifting, or redefining government functions as previously stated, that has been deemed as a key to the success of the reform, is always being forced upon the government. In other words, the government has been quite reluctant in releasing its power to other players. Two reasons could be traced to, one is what is called "the fixed mode of thinking" or "path - dependency", and the other is some kind of inertia in administrative system.

As well, previously stated two factors, that is, the huge size of the present government and the incentive of its officials, may well be effective in this regard.

In Zhuchen's case, given the situation where there was no longer the existence of so-called "state - shares" and "collective shares" after the reform of the first round, the direct involvement of the local government in the second round would be tantamount to the encroachment upon private properties. The questions of "if, when and how" in those SOEs' shake-up should not be the concern of the government any more. Obviously, the government did not aware of this all along as it was forcing its way through the second round in the hope of scoring second time by coping the stunt of the first. Having said that, it becomes clear that the more important issue that the case should have probed into ought to be that of limit in the government's role and of the manner taken in its conduct.

In stark contrast, Longdo Real Estate case has projected different kind of government in terms of its role assumed and the manner of conduct adopted. Here, the real star in the show is an enterprise, Longdo Real Estate, whereas the local government takes a supportive role of co-player. As the trade in the right to use in public housing was under on circumstances deemed as lawful, Longdo, driven by huge potential profits in the public housing market, set off its uncertain journey of innovation by venturing through the loopholes of the existing legal regime.

In 1994, two official documents came into being in tandem. One was *Regulations of Real Estate Markets in Tianjin* that endorsed the exchange in owner occupied units with a price disparity. The

other was *Regulations of Rental Markets in Urban Areas* by Ministry for Construction, which legalised the benefit gains from subletting public housing units. As the company realised the existence of the two documents, so did the sideswiping game of commercialising public housing start in the form of exchange in the right to use. On the other hand, the local government did not rush into a lawsuit filed against the company. Instead, it sat on its hands, tight-lipped while watching. Indeed, it was the government that was playing with fire.

Then, there was some city's surveillant office that filed a report to the department concerned against the conduct of the company. Nonetheless, the government seemed in no mood to respond. Meanwhile, Longdo continued inching through the minefield, expanding its business and even openly trading in "Real Estate Exchange" organised by the government. Having been rebuffed by its superior, the surveillant office had not much choice but accepted such an "unlawful" business activity.

In 1996, a far-ranging investigation was underway by Tianjin Housing Bureau (or THB) over the activities of Longdo Real Estate. During the period, however, Longdo's expansion continued. Contrary to the conventional wisdom, a widespread crackdown on the business activities did not ensue in the wake of the investigation. Rather, the government was waging a publicity campaign both internally and externally through research seminars, news media, and official reports. The upshot was the approval of the certain department in the central government, and the "unlawful" business conduct was at length legalised along with the five official docu-

ments, entitled *Regulations on the Market for Public Housing* by THB. The spontaneous innovation has as such become a formal institutional arrangement.

That said, it ought to be clear to us that, from time to time, the role of government in the reform need not be as that of vanguard blazing the trail. With no reliable maps or compasses, and much information fog, the risk of navigational error is always high. Instead, being conformative or supportive by creating a benign environment for the market players may prove to be more effective. Hence, what we need in the period of transition is not whatever almighty government or some sort of reckless officials. Here, more relevant is wisdom that would, admittedly, be obtained only through the reform practices.

Contractual Relationship

To a certain extent, the market relationship can be better reflected by its multi-centric contractual arrangements that encompasses individuals and firms. In contrast, a command system may best be depicted as a gigantic uni-centric enterprise of state in which arm's length market exchanges or contractual relationship amongst individuals and individualised firms are not in existence, as it is, for all practical purposes, void of the regime of private property rights.

The transition towards a market-based economy, therefore, is a process by which private property-rights will be reinstalled so that subsequent trade in the form of contractual agreements can take place. Only then, we could possibly think about the improvement of the price system. For such a reason, most of cases selected in

this volume involve, one way or another, the issue of how to put in a mechanism that would facilitate such a process of bringing in some private contractual relationship in a predominantly publicly run organisations.

As well known in a public – ownership regime, the property of economy, though theoretically belongs to the general public, is effectively possessed by nobody. In the incidence of the relationship between the state and its workers, the government as the representative of the public has no right to dismiss its working masters – what is coined as real owners of the enterprise of state. On the other hand, these masters in return forgo the right to own their labour resources that, of course, also belong to the general public. Thus, markets for labour will be absent, as property rights of the resources are missing from the way in. The upshot is a tremendous waste induced, as the economy becomes more complex.

As such, some kind of market – based reform becomes imperative. Yet, a balance has to be stricken between efficiency gain and social stability, given the possible suffering resulted from the reform. Here again, the notion of efficiency improvement would be the key in such a transition where a government will “buy out” those erstwhile working masters to become the effective owner of these enterprises – the corporatisation movement. Workers, in return, will regain their labour resources as private commodities that can be traded in the markets. Nonetheless, some mechanism has to be put in place to facilitate “fair” campaign of “ownership buy – out”.

In the story of East Asian Woollen Mill, a state – owned manufacturer, a detailed discussion on the process of reinstalling the private