Chapter Seven

Contracting and Dispute Resolution among Chinese Firms: Law and Its Substitutes

Susan H. Whiting

INTRODUCTION

Litigation of contract disputes in China has increased markedly since the initiation of economic reform three decades ago. Yet, the decision of firms to enter the court system is surprising, given the widely accepted views of Chinese courts as handmaidens of party-state officials and of Chinese citizens and firms as nonlitigious. This chapter analyzes the contracting practices and choice of dispute-resolution mechanisms on the part of Chinese firms in the domestic political economy. It explores the hypothesis that, in the rapidly changing context of China's transition from socialism, both the informal networks in which firms are embedded and the bureaucratic structures by which firms are governed fail to provide adequate information and sanctions for the resolution of disputes, making the courts an increasingly important element in the process of dispute resolution. Indeed, despite the emphasis of the party state on mediation and arbitration and the establishment of an array of new institutions for these purposes, litigation increased at an average annual rate of 24 percent per year during the 1980s and 1990s, before leveling off in the 2000s.[1]

In theory, courts, as neutral third-party arbiters of disputes, become increasingly important as the volume of arms-length market transactions in the economy increases. This research explores the changing role of the courts in the Chinese political economy in order to evaluate this claim. In 1996, Chinese Communist Party (CCP) General Secretary Jiang Zemin called for China to build a "socialist rule of law state," and in 1999, the constitution was amended to assert that "The People's Republic of China exercises the rule of law, building a socialist country governed according to law." Thus, litigation increased simultaneously with an ambitious political initiative to promote legal development.

Table 7.1. Cases Accepted by Courts of First Instance

	Economic	*Civil*	*Administrative*	*Criminal*
1983	44,080	756,436		
1984	85,796	838,307		
1985	226,695	846,391		
1986	322,153	989,409		299,720
1987	366,456	1,213,219	5,240	289,614
1988	508,965	1,455,130	8,573	313,306
1989	690,765	1,815,385	9,934	392,564
1990	588,143	1,851,897	13,006	459,656
1991	563,260	1,880,635	25,667	427,840
1992	652,150	1,948,786	27,125	422,991
1993	894,410	2,089,257	27,911	403,267
1994	1,053,701	2,383,764	35,083	482,927
1995	1,278,806	2,718,533	52,596	495,741
1996	1,519,793	3,093,995	79,966	618,826
1997	1,483,356	3,277,572	90,557	436,894
1998	1,455,215	3,375,069	98,463	482,164
1999	1,535,613	3,519,244	97,569	540,008
2000	1,297,843	3,412,259	85,760	560,432
2001	1,155,992	3,459,025	100,921	628,996
Avg growth	18.8	8.3	21.8	4.7

Sources: *Quanguo renming fayuan sifa tongji lishi ziliao huibian 1949-1998 (Mingshi bufen)*, 2000 (Beijing: renming fayuan chubanshe; Zhongguo falu nianjian), various years.
Note: while 2002 data is available, the revision of the Contract Law in 1999 led to changes in the handling and reporting of economic disputes in the courts. Those changes were implemented at the district court level by 2002, resulting in incomparable reporting categories. At present, adequate data to correct for those changes is not available.

This study addresses major theoretical debates in the fields of comparative politics, political economy, law and development, and China studies. Dramatic increases in litigation raise anew questions about the necessity of effective courts for sustainable economic growth.[2] The work of Max Weber establishes the claim that a rational legal system, which lends the predictability of universally applied rules to market activity, is essential for economic growth.[3] Douglass North's work further establishes the importance of legally constraining potentially predatory state actors from undermining property rights and thereby economic growth.[4] North also emphasizes the importance of providing a neutral third party to underpin arms-length contracting. "How effectively agreements are enforced is the single most important determinant of economic performance. The ability to enforce agreements across time and space is the central underpinning of efficient markets."[5] These claims have been accepted and propagated in recent years not only by scholars but also by multilateral institutions like the World Bank and the United Nations Development Program.[6]

However, these theoretical claims have also been challenged in both Western and Asian contexts. Stewart Macaulay's seminal work on noncontractual relations in U.S. business highlights the high frequency of dispute resolution without resorting to formal, legal processes or legal sanctions.[7] Similarly, Robert Ellickson finds that community norms rather than the law govern the resolution of everyday disputes in rural communities in the United States.[8] In the context of contemporary Chinese society, the works of Jane Winn and Carol Jones both emphasize the importance of the cultural practice of *guanxi* (social connections) in enforcing contracts and resolving disputes.[9] Traditional cultural norms against litigation are vividly captured in phrases, such as "to enter a court of justice is to enter a tiger's mouth."[10]

Indeed, in the contemporary context, not only cultural norms and practices but also the flawed nature of the legal system itself may mitigate against using the courts.[11] Courts in the PRC are subordinate to the party, lack competent judges, and have weak enforcement powers.[12] In light of these cultural and institutional features of the Chinese system, the dramatic increase in the litigation of economic disputes appears surprising.

Others, following the law and development literature, argue that an increase in arms-length market transactions and a growing role for the courts must inevitably go hand-in-hand in China.[13] While the economic growth of the Chinese economy over the past quarter century hardly needs substantiation, a debate exists around the theoretical centrality of nonlitigious, relational versus formal, institutionalized dispute resolution mechanisms in underpinning this growth. The debate has larger implications for the study of comparative politics; in particular, it contributes to arguments about the relationship between institutions and culture that arise with respect to both legal development and democratization.[14]

Finally, this study seeks to contribute to the growing literature on the empirical study of law by focusing on the arena of disputes over contracts for exchange of goods and services.[15] In doing so, it builds on recent research in the economics of transition, which offers empirically based and theoretically nuanced assessments of the relationship between relational contracting and formal legal institutions in transition economies, including the former Soviet Union, Eastern Europe, and Vietnam.[16] Scholars of China have also begun to redress the relative lack of empirical evidence on dispute resolution—and on the legal system more generally.[17] This chapter is based upon results of analysis of a representative sample of seventy-six purchase and sales contract disputes from 1999 to 2001 from one district court in Nanjing, and a convenience sample survey implemented through face-to-face interviews with seventy-six enterprise managers conducted in Nanjing and Shanghai between 2002 and 2004.[18] The questionnaire focuses on firms' experiences with

contracting and dispute resolution. In particular, it explores the full range of mechanisms for resolving contract disputes, ranging from informal and formal mediation, arbitration, and litigation, to nonlegal, coercive mechanisms. The paper also draws on original data provided by the World Bank Study of Competitiveness, Technology, and Firm Linkages.[19] On this basis, the chapter seeks to evaluate the extent to which a well-functioning legal system—as opposed to political and/or cultural substitutes—provides the basis for securing intertemporal transactions and, therefore, economic growth. Both the Nanjing and Shanghai data and the World Bank data are drawn from large cities, where economic exchange is concentrated, where judges are likely to be better educated, and where lawyers are available; thus, these data are more likely to reflect the most advanced segments of the economy and the legal system.

The paper proceeds as follows: it first examines the evolution of contract law governing exchange of goods and services in order to explicate the legal/regulatory basis for contracting and to provide a starting point for assessing the relevance of these rules for contracting behavior. The second section looks at the nature of contracting behavior, evaluating the extent to which firms engage in arms-length vs. relational contracting. The next section analyzes the range of dispute resolution mechanisms in order to evaluate the role of law and its substitutes. The fourth section presents a discussion of attitudes of business owners and managers toward the legal system and its role in the economy. The conclusion addresses the relevance of this research to larger arguments about China's "rule-of-law" initiative and the relationship between institutions and culture.

EVOLUTION OF CONTRACT LAW

The first reform-era laws governing contracts—the 1981 Economic Contract Law (ECL), the 1985 Foreign Economic Contract Law (FECL), and the 1987 Technology Contract Law (TCL)—evince significant flaws when evaluated on the basis of the following criteria of a well-regulated market economy: (1) Does the legislation create a level playing field for all firms? (2) Does it enable parties injured by breaches to enforce the rules and receive compensation? and (3) Does it allow nonstate actors to put the coercive machinery of the state in motion in service of their legitimate interests? As subsequent paragraphs demonstrate, these weaknesses were ameliorated in part by the amendment of the ECL in 1993 and the promulgation in 1999 of a new, unified Contract Law (CL), which was much better suited to a market economy characterized by a diversity of ownership forms. In addition, the new law addressed the "inconsistent norms and competing institutions" created or

codified by the three initial contract laws and the 1986 General Principles of Civil Law.[20]

The first Economic Contract Law of the PRC, promulgated in 1981, embodied many of the concepts developed through regulations put in place in the 1950s and 1960s.[21] The Soviet concept of "economic contract" was adopted with the socialist transformation of the economy in 1956 and perpetuated by the ECL into the early reform era.[22] Under planning, economic contracts were nothing more than a means of implementing the plan, and contracts violating the plan were void.[23] At the same time, administrative changes to the plan were common reasons for nonperformance.[24] Other aspects of the law were also restrictive, including the requirement that contracts be in writing.[25] As Bing Ling notes, this requirement was "one of the major problems of the pre-1999 law, whereby a contract [could] easily become void."[26] Moreover, according to the ECL, only legal persons[27] (*fa ren*) could sign economic contracts; the intent of the law was that only enterprises "subject to state control could enter into meaningful economic activity."[28] However, the growing participation of individuals, who by definition were not legal persons, and private enterprises, which were often unable to obtain legal person status but which were increasingly parties to contracts, presented a challenge to the ECL.[29]

While political and social substitutes for law created openings for individuals and private enterprises that were not legal persons to enter into contracts, the absence of a basis in law still hindered the development of the nonstate economy prior to the early 1990s.[30] Although the literature provides only anecdotal and case study evidence here, one can surmise that the growth of the private sector might have advanced more quickly under a more encompassing contract regime. Legal obstacles in the ECL were evident even in places like Wenzhou, where the private economy enjoyed strong local political support and extensive social networks. According to an official in Yueqing County, Wenzhou, before the amendment to the ECL in 1993, many firms outside of Wenzhou refused to enter into contracts with private enterprises there.[31] Furthermore, private enterprise owners felt they had no recourse when they encountered contract disputes, since courts were unwilling to recognize their claims.[32] Moreover, informal solutions to these contracting problems were vulnerable during the 1980s and early 1990s to official crackdowns, like the closure of Wenzhou's informal commodities markets (supplying steel, lumber, and cement to private firms) by the State Administration of Industry and Commerce—the state agency responsible for administering economic contracts.[33] Thus, under the ECL regime, private enterprises functioned only within the quasi-legal or illegal interstices of the planned economy.[34]

Amendment of the ECL in 1993, along with authoritative interpretations of civil law by the Supreme People's Court (SPC) in the early 1990s, addressed

many of these problems. The amended ECL did away with many provisions that perpetuated the dominant role of the state plan and greatly "expanded the scope of the 'economic contract' concept."[35] These changes included allowing "other economic organizations" to qualify as parties to economic contracts. Authoritative interpretations by the SPC had already defined "other organizations" to include properly registered and licensed solely owned private enterprises, partnerships, foreign-invested enterprises, and branches of legal persons.[36] Essentially, any properly registered and licensed business entity could now enter into legal contracts. With the changes in the contract regime beginning in the early 1990s, firms that were properly registered and licensed, like those in Yueqing, Wenzhou, alluded to above, could enter into legally enforceable contracts.

The unified Contract Law, passed by the National People's Congress in 1999, reflects the principles of good faith, fostering transactions, and freedom of contract.[37] For example, natural individuals—not just legal persons—can now enter into legally enforceable contracts, and oral contracts are recognized as valid for the first time, significantly expanding the scope of contract. The principle of freedom of contract signals a definitive move away from the planned economy.[38] The law limits the scope of contracts to be monitored by administrative organs; for example, it limits administrative supervision of contracts by the SAIC to illegal acts.[39]

These changes are clearly reflected in court records. This paragraph draws on the analysis of a representative sample (n = 76) of purchase and sales contract disputes from 1999 to 2001, from one district court in Nanjing, the capital of Jiangsu Province. It is possible to identify the ownership form of the plaintiff in 70 percent of the court records in the sample. Private enterprises are the plaintiffs in 34 percent of the cases; firms with mixed public/private investment are the plaintiffs in another 15 percent of the cases. While it is possible to identify the ownership form of the defendant in only 37 percent of the cases, private enterprises are the defendants in 36 percent of those cases and mixed public/private firms are the defendants in another 14 percent of the cases. Thus, the records show that the principle of freedom of contract enables private enterprises to enter into legally enforceable contracts and enjoy recourse to the courts—features of the contract regime that were absent through the early 1990s. The records also show how the law served to foster transactions by recognizing oral contracts. In 89 percent of the cases, it is possible to identify the form of the contract—oral versus written—and oral contracts are in dispute in 46 percent (n = 31/68) of those cases. Moreover, reliance on oral contracts does not, in and of itself, appear to unduly prejudice the hearing a plaintiff can receive. In the Nanjing court sample, the court found for the plaintiff, resulting in payment of compensation by the defendant, in 55 percent (n=17/31) of the cases involving oral contracts.

Having examined the evolution of contract law and its growing ability to serve a more marketized economy featuring a range of ownership forms, the chapter proceeds in the next section to focus on the actual contracting behavior of firms.

ARMS-LENGTH VS. RELATIONAL CONTRACTING

Stewart Macaulay opens his seminal 1963 article on noncontractual relations in business with the question, "What good is contract law?" While changes in the legal contract regime that level the playing field and improve access to legal recourse are central to the work of both Weber and North, scholars working in contexts as diverse as American and Chinese business communities emphasize the extent to which contractual relations are grounded in informal social ties and not in legal rules and sanctions.

The treatment of relational contracting in Chinese societies focuses on the concept of *guanxi*. As Wai-Keung Chung and Gary Hamilton indicate, "Chinese relational rules personalize transactions, making them part of the interpersonal social matrix of daily life . . . thereby increasing the calculability of economic outcomes."[40] In the context of the People's Republic of China in particular, the discussion of *guanxi* links not only relations among entrepreneurs, but also relations between entrepreneurs and government officials.[41] One explanation of the expansion of economic exchange, then—even preceding significant legal change—centers on dense, interpersonal networks that extend into the government apparatus. Victor Nee and Sijin Su focus on "long-standing social ties based on frequent face-to-face interactions" as an important basis for trust and cooperation between entrepreneurs and the government in the Chinese political economy.[42] They emphasize that "transaction costs are lower in institutional settings where trust and cooperation flow from informal norms and established social relationships." Dense interpersonal networks provide information as well as opportunities to impose sanctions that are important to the establishment of trust. In a similar vein, Nan Lin and Chih-jou Chen emphasize thick relationships based on familial ties.[43] Ambrose King finds that "network building is used (consciously or unconsciously) by Chinese adults as a cultural strategy in mobilizing social resources for goal attainment in various spheres of social life.[44] To a significant degree the cultural dynamic of *guanxi* building is a source of vitality in Chinese society." As this statement suggests, the social network explanation

of trust in contractual relations is related to accounts of Chinese culture that emphasize the importance of networks of relations (*guanxi*) as a widespread sociocultural phenomenon.

However, recent studies raise questions about the extent of reliance on *guanxi* as markets for factors and products become more complete.[45] Identifying contracting partners through social ties is important, particularly in the absence of well functioning legal institutions. In theory, social ties provide an alternative set of opportunities for monitoring and enforcing contractual performance, since social ties facilitate the flow of information within a defined network.[46] What does available data tell us about the social basis of contractual relations? Zhou Xueguang et al. find that, while social networks are important, firms rely on a range of search channels to identify contractual partners.[47] Social networks (47.1 percent) and open information sources including advertisements, media, and trade information (47.0 percent) predominate, followed by self-initiative. The survey data in my study of Nanjing and Shanghai firms show that professional ties predominate over social ones; in identifying suppliers, firms rely on business associates (41.4 percent), trade conferences (12.9 percent), advertising (11.4 percent), and self-initiative (10 percent) as the major sources of contacts. Friends account for only 8.6 percent[48] (figure 7.1). In identifying customers, firms report relying upon business associates (42.9 percent), competitors (21.4 percent), trade conferences (18.6 percent), and advertising (14.3 percent), as well as self-initiative (i.e., approaching the potential client directly; 10 percent), and friends' companies (10 percent) (figure 7.2). Thus, social networks are only one of many search channels for contractual partners. This finding is consistent with the extremely rapid expansion of economic exchange, particularly in major cities.

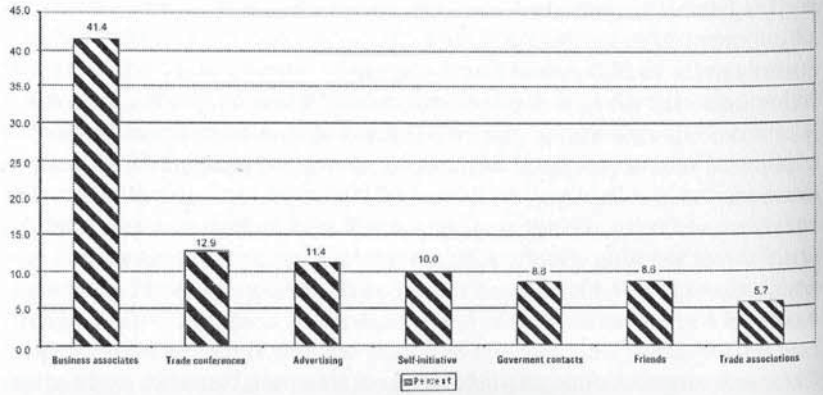


Figure 7.1

Moreover, despite the role of social networks, formal, written contract provisions have become the norm; more than 75 percent of the firms in the study by Zhou et al. used such provisions to specify volume, quality, price, deadlines, and contractual safeguards.[49] Written contracts appear even more pervasive in other studies. The data from Nanjing and Shanghai demonstrate that firms use written contracts with suppliers in 90.5 percent of cases, while they use written contracts with customers in 98.6 percent of the cases. Similarly, the World Bank data also show that the use of written contracts is the norm, found in 90.1 percent of contracts with clients and 82.2 percent of contracts with suppliers. Zhou et al. find that "contracts initiated through social networks have a higher probability of having informal provisions," but, crucially, the effect is small: "Network ties play a statistically significant but substantively minor role in the choice of contract forms and provisions."[50] In other words, business people in these studies rely overwhelmingly on formal contracts in economic exchange. The reliance on formal contracts has important implications for the nature of dispute resolution. As one manager interviewed said, if we have delivery or product problems with a supplier, we first go to the contract.[51]

Trade associations perform an important function in promoting the use of formal contracts and are often involved in popularizing the use of state-approved, industry-specific form contracts.[52] For example, according to the Shanghai Municipality Regulations on the Management of Form Contracts (*Shanghaishi geshihetong guanlitiaoli*), trade associations in Shanghai draft form contracts, which are reviewed and approved by the municipal level of the State Administration for Industry and Commerce and by the relevant

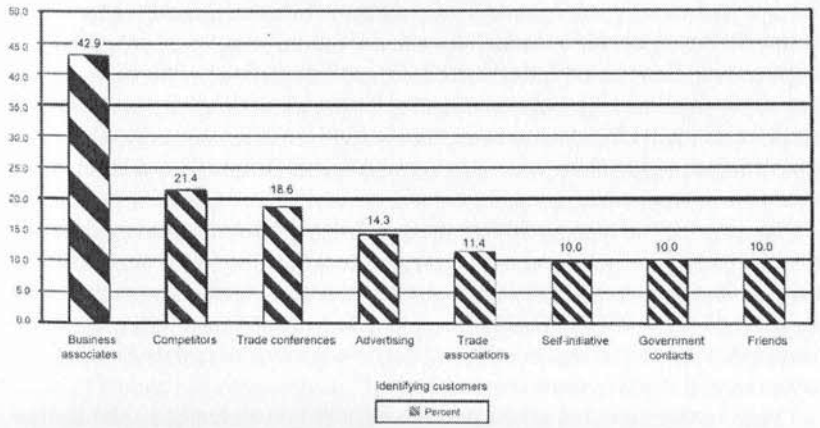


Figure 7.2

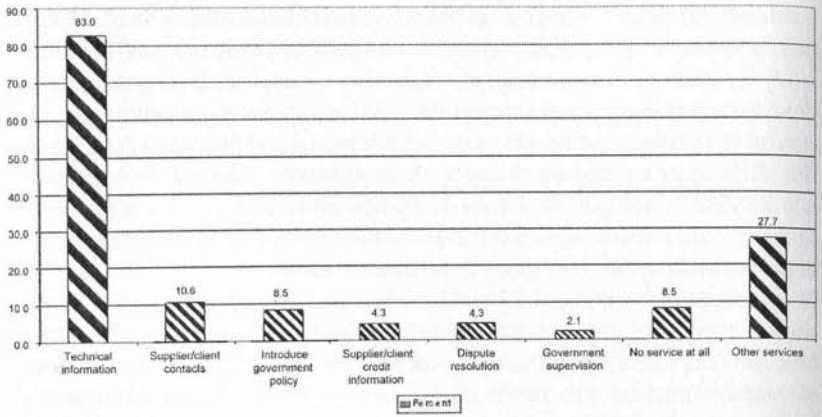


Figure 7.3

ministerial bureau. Trade associations then provide these form contracts for use by their members.[53]

However, trade associations are limited in their ability to provide information about contractual partners that would underpin relational contracting without recourse to the formal legal system. In the Shanghai and Nanjing survey, 67.1 percent of respondents were members of trade associations, yet managers dismissed their role in contract formation or enforcement. Most managers reported relying on trade associations for technical information (83 percent), while only some reported that trade associations provide a forum for making supplier or client contacts (10.6 percent; figure 7.3). Revisiting figure 7.1, we can see that 5.7 percent of managers reported actually identifying suppliers through trade associations, and 11.4 percent reported actually identifying customers through this means (figure 7.2). Indeed, trade associations appear limited as a basis for evaluating potential trade partners. Very few respondents said that associations provided information on credit worthiness (4.3 percent; figure 7.3). A smaller percentage of firms (54.5 percent) were members of trade associations in the World Bank dataset, and the survey taps a somewhat different array of functions: With respect to evaluating the creditworthiness of potential business partners, less than one third of the managers reported that these associations could "accredit members to suppliers or customers"[54] (figure 7.4). Rather than providing contacts and information that would underpin relational contracting, trade associations appear to link firms to the formal, legal system.

Other institutions that could provide information to facilitate the evaluation of potential contractual partners were largely absent or faced significant

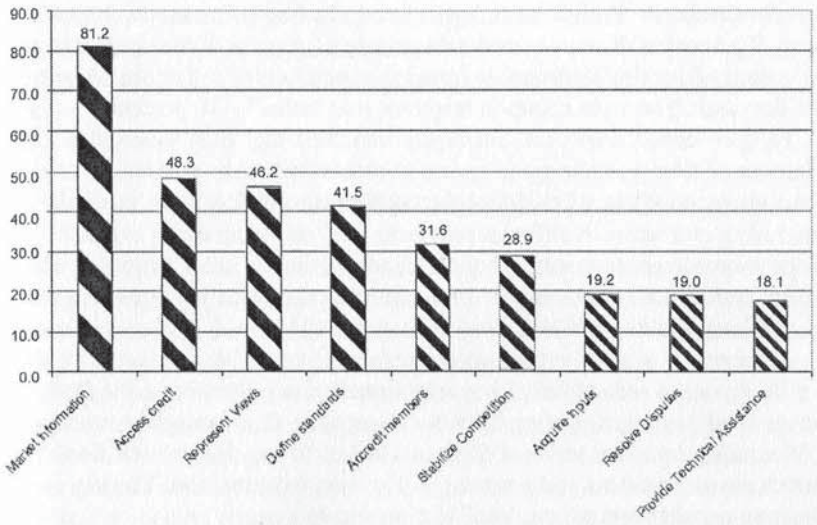


Figure 7.4

regulatory hurdles at the time of the enterprise survey. Credit bureaus are a noteworthy example. Only a few specially approved credit bureaus were in existence. A lawyer in Nanjing commented, "China's credit system is underdeveloped. There is no unified system for [evaluating] enterprise credit; there's no way to investigate an individual manager's creditworthiness (*zhongguode xinyongzhidu bufada, meiyou yige tongyide qiyexinyongtixi, wufakaocha mougejingyingzhede xinyu*)."[55] In 2001, the State Council set up a "Group for Enterprise and Personal Credit Investigation" to propose legislation governing business and consumer credit bureaus.[56] As of July 2005, Wan Enxiang, Vice President of the Supreme People's Court, described the credit reporting system as "lacking (*queshi*)," with the result that enterprises and individuals who don't pay their debts are never sanctioned.[57] In 2007, the State Council Office issued "Several Opinions Regarding Building a Social Credit System."[58] These guidelines highlighted the importance of information for contract performance and product quality as well as for loan repayment. To date, the People's Bank of China has been the central player, and regulations for credit-reporting agencies are likely to require a "very high level of minimum capitalization, as if they were financial institutions."[59] This requirement is, in essence, a barrier to entry. As Su Ning, Deputy Governor of the People's Bank of China, has commented, "In the preliminary stage of the credit reporting industry, supervision by the government might be quite strong."[60] In the Shanghai and Nanjing survey, when asked explicitly how they evaluated the

creditworthiness of customers, managers indicated using credit bureaus in only 9 percent of the cases and banks in only 15 percent of the cases. Managers reported seeking information from other suppliers of a client in 26 percent of the cases. The most common response was "other"—39 percent.

In open-ended responses, managers indicated that they invested a large amount of time and energy in trying to assess the credit-worthiness of new customers on their own. Managers described visiting new customers—including customers in different provinces with attendant travel expenses—at least three times on average.[61] One manager initially took the fancy apartment and famous-make car of one contract partner to be signs of creditworthiness—until he failed to pay (Enterprise #1).

Managers also rely on the two parties' narrow self-interest in the shadow of the future to reduce risk. They intentionally keep the size of the first few deals small before expanding the size of contracts. One manager commented, "We mainly look at a series of deals and ability to pay. Before, we didn't pay much attention to this and got burned. Now we pay attention. The key is not to have unpaid accounts payable" (Enterprise #61).

At the same time, however, managers face significant competition, generating pressure for them to contract at arm's length in order to offer the best terms on price and quality to customers. Fully 80 percent (81.8 percent) of respondents in the Shanghai and Nanjing survey characterized competition in their core product markets as "intense" or "very intense." Managers interviewed suggested that foregoing the most efficient contracting opportunities could result in a loss of market competitiveness for their firms.

The picture of contracting presented here is one of transactions divorced in most cases from pre-existing social ties, and yet not well supported by other state or nonstate institutions like trade associations or credit agencies.[62] The findings from major cities suggest less reliance on relational contracting and greater use of formal, written contracts than expected, based on the existing literature. These findings have implications for dispute resolution. We can contrast such contract-based approaches to economic exchange with more trust-based approaches:

> When two enterprises trade with one another over an extended period, their officials might develop bonds of personal trust that override any fears of contractual non-performance. Then, the relationship no longer depends upon a detailed calculus of the other party's motives. In such cases, the written contract is largely superfluous. Any specific element of agreement between the two parties can only be understood in the context of the whole relationship. If problems arise, they are resolved through negotiations, without involving outsiders. Adjustments occur without recontracting. Resorting to the courts or even bringing in lawyers can be corrosive, since such actions signal a decline of personal trust.[63]

The results presented in this section suggest that when firms do encounter disputes, there are few effective substitutes for an institution like the courts in dispute resolution. The following section investigates this hypothesis in detail.

DISPUTES AND DISPUTE RESOLUTION

In the survey of firms in Shanghai and Nanjing, 55 percent reported experiencing one or more self-defined "disputes" in the preceding year. According to data drawn from the World Bank survey of 1,500 Chinese firms, in the year 2000, 31.1 percent of firms had one or more "major disputes" with clients, while 21.9 percent of firms had one or more major disputes with suppliers. Once enterprises encounter disputes, what mechanisms do they rely upon to resolve these disputes? Theorists from Weber to North emphasize the importance of formal, state-sponsored legal recourse. As Weber asserts, "In a capitalist society, economic exchange is quite overwhelmingly guaranteed by the threat of legal coercion . . . a stable private economic system of the modern type [would be] unthinkable without legal guarantees."[64] Yet, as noted above, there is a large literature on contractual relations, spanning cases from the United States to Asia, which indicates that contract disputes are often resolved outside the courts. This section examines the dispute resolution mechanisms employed by Chinese firms and finds that the courts play a moderately important role in the strategies firms employ. The importance of the courts likely reflects a number of factors, particularly the relative absence of effective alternatives in the context of cut-throat competition. The following paragraphs address self-enforcing contracts, direct negotiation, mediation, arbitration, litigation, and the ability to enforce judgments.

Self-enforcing Contracts

Self-enforcement, in which two parties bargain to attain a long-term cooperative solution based on the anticipated value of future contracts, is an important mechanism in contractual relations with Chinese firms; enforcement is based in part on the threat to stop trading. As one manager in Nanjing noted, "If a client is very late with payment, we stop doing business with them."[65] Moreover, in the study of businesses in Shanghai and Nanjing, 90.6 percent of firms reported that in the event of a serious dispute, their long-term reciprocal relations with a supplier or contractor would be broken.

It is possible for reputation to function within the dyadic contractual relationship. In the Shanghai and Nanjing data, the average length of contractual

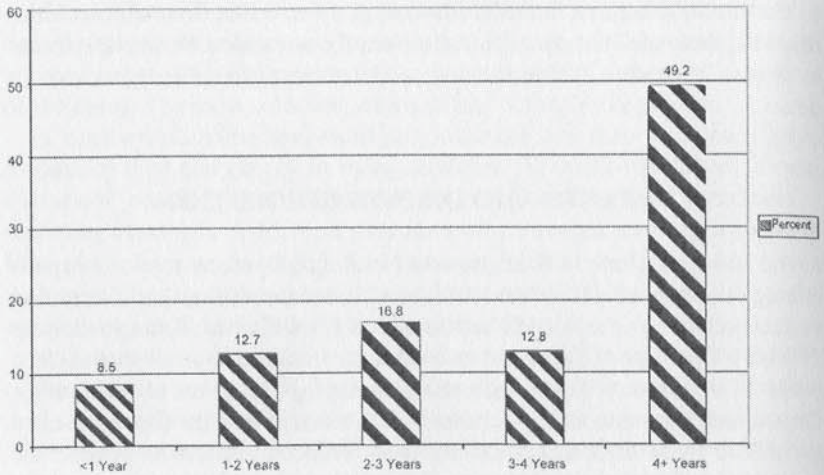


Figure 7.5

relations with major clients was about 7.5 years, while the median length of the relationship was 5.5 years. In nearly 50 percent of firms in the World Bank dataset, the average length of the business relationship with major suppliers and clients was four years or longer (figure 7.5). Furthermore, reputation also functions within business circles to help police contractual relations. Contract partners are concerned with the future value of contracts not only with one firm but with a group of firms. In Shanghai and Nanjing, 74.2 percent of firms said that other businesses would know about it if a dispute arose between the firm and one of its suppliers. Here, economic (as opposed to strictly social) networks are important sources of information, not only in the search for contractual partners, but also in the attempt to enforce contracts—particularly in the absence of credit evaluation services as noted above.

Partial prepayment is another common strategy to minimize risk in an information-poor environment without reliance on the formal legal system; this practice builds in conditions that encourage enforcement.[66] In 28 percent of cases, managers described relying on partial prepayment, particularly for new customers. In these cases, typical payment terms were: 30 percent in advance, 40–60 percent upon delivery, and 10–30 percent within thirty days of delivery.[67]

Direct Negotiation and Mediation

Negotiation directly between the contracting parties is the norm for resolving contract disputes. "No matter what firm or what dispute, enterprises' first [step]

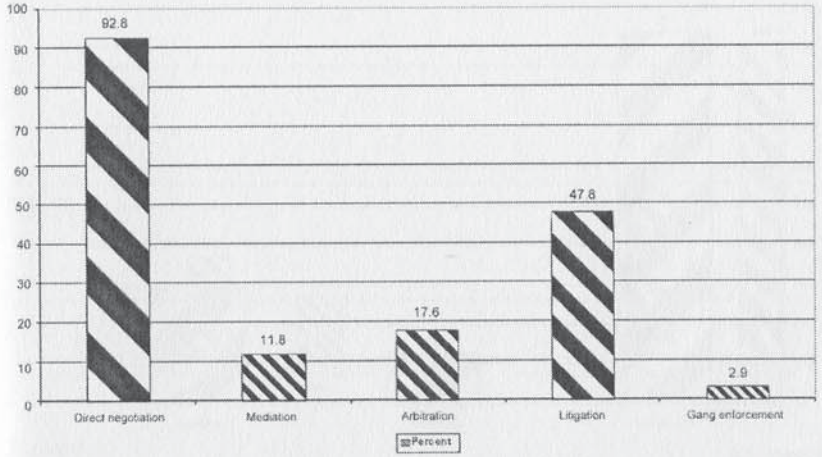
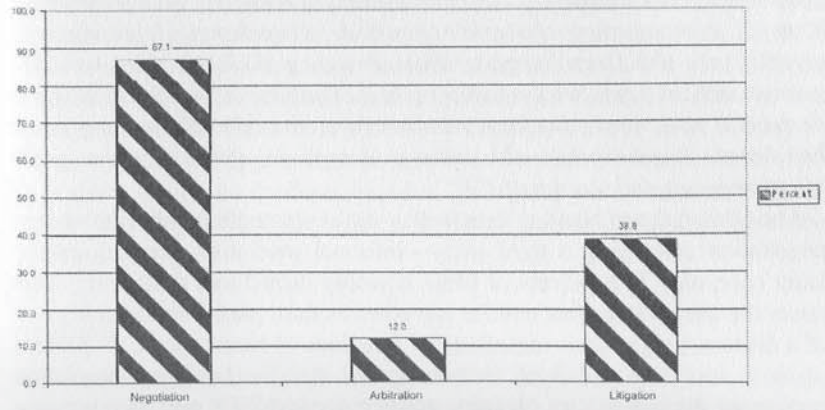


Figure 7.6

is direct negotiation. On the one hand, [this approach] minimizes costs, and, on the other hand, it maintains good relations (*buguanshishemeqiye, shemejioufen, qiyeshouxiande kengdingshi xieshang, yifangmian keyijieyuechengben, lingyifangmian haikeyibaochi haodeguanxi*)."[68] In Shanghai and Nanjing, 92.8 percent of firms attempted direct negotiation (*xieshang*) to resolve disputes. (figure 7.6.) In the World Bank survey, 87.1 percent of firms used negotiation in the final resolution of disputes with at least one client, while 93.2 percent used negotiation in the final resolution of disputes with at least one supplier. (figures 7.7 and 7.8.)



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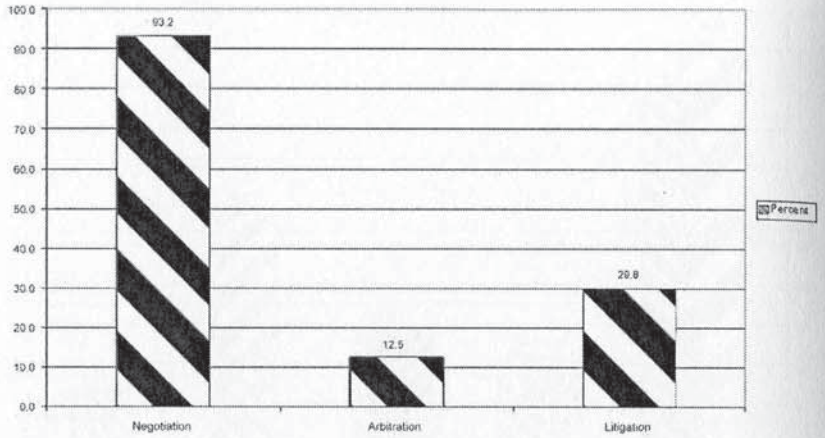

Figure 7.8

In direct negotiation, business leverage is likely to be an important factor in determining the outcome.[69] One Nanjing manager who sourced steel from Baoshan Steel (*Bao Gang*) described them as "tough (*niou*)," and said that when disputes arose with that company, he had to "take it or leave it."[70] An unrelated lawyer also from Nanjing commented on Baoshan Steel's business leverage: "In some disputes, the cause and the solution are determined by the enterprise's leverage, for example, Baoshan Steel. Baoshan Steel is a large enterprise—a supplier with a lot of leverage and with a lot of long-term business partners. But, if a Baoshan product has a problem, the buyer won't look to Baoshan [to make good]. Because Baoshan has tremendous market leverage, you can't afford to offend them. Of course, after such a problem [has occurred], it [i.e., Baoshan] may [choose to] give some other form of compensation (*haiyoude jioufende chanshenghejiejue qujueyu qiyezhijiande shili, biru Baogang delizi. Baogang shidaqiye, henyoushilide guenghuoshang, youhenduo changqihezuohuoban. danruguo Baogang dechanpin youlewenti, dueifang yebuhuei laizhaota. yinwei Baogang juyou henqiangde jingzhengshili, nidezueibuqi. dangranle, shihou tayehuei geiyu mouzhuengxingshide buchang*)."[71]

The Shanghai and Nanjing data further differentiate direct negotiation and negotiation employing a third party—informal mediation (*tiaojie*). In the latter case, only 11.8 percent of firms typically turned to a third-party. This raises the question of what entities can serve as third parties in the mediation of a dispute. In questions regarding the functions of associations, 19 percent of firms in the World Bank dataset agreed that the business association performed the function of "helping resolve disputes" for any member (not

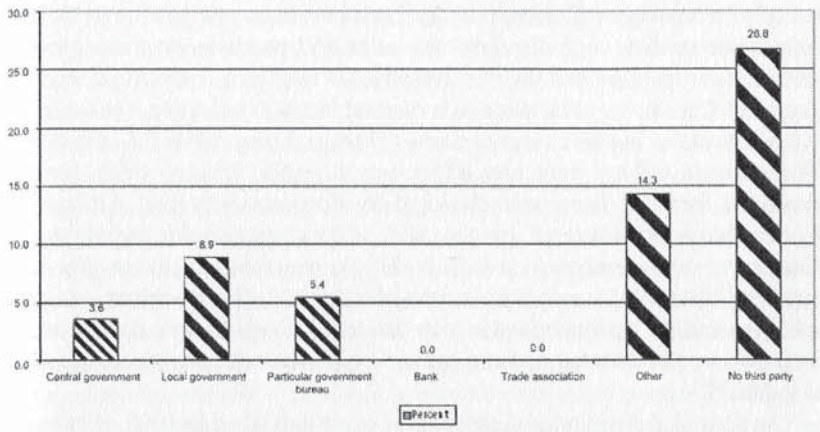

Figure 7.9

necessarily themselves). As a Nanjing lawyer commented, "China also has trade associations, but they have little influence; they're of no use in resolving disputes (*zhongguo yeyou hangyexiehuei, danshi tamende lilianghenxiao, zaijiejue jioufenfangmian fahueibuliao shemezuoyong*).[72] Only 4.3 percent of respondents in the Shanghai-Nanjing data indicated that trade associations contributed to dispute resolution. In the context of their direct experience with dispute resolution, moreover, no managers reported having the assistance of their trade associations. Strikingly, the most common response (26.8 percent) was that there was no suitable third party available to mediate (figure 7.9.) "Other" alternatives (14.3 percent) commonly referred to a respected individual known to both parties. In only a small percentage of cases were government bureaus at any level deemed useful as third-party mediators.[73] This represents a major change from the role of government under the planned economy, in which government bureaus often undertook the mediation of disputes between subordinate firms, and challenges Lubman's claim of the "persistence of devotion to mediation."[74] Overall, what is most striking is the apparent lack of appropriate third parties—formal or informal—available to business people to mediate disputes. This finding is consistent with the rapidly changing market environment in which there is significant new entry by firms.

Arbitration

While arbitration is the "preferred method" of dispute resolution by foreign investors in China,[75] leading some scholars to characterize it as "a key part of

the official legal system" more broadly,[76] arbitration plays a surprisingly small role in the resolution of disputes over sales and purchase contracts among domestic firms.[77] As one lawyer remarked, "Domestic enterprises mainly sue; very few choose arbitration as a method to resolve disputes (*guoneiqiye yisusongweizhu, xuanzezhongcai zuowei zhengyi jiejuefangshidehenshao*)."[78] The Arbitration Law went into effect only in 1995. Prior to 1995, similar functions for local firms were handled by Economic Contract Arbitration Commissions administered by the State Administration for Industry and Commerce and were pursued in a highly bureaucratic and often arbitrary manner.[79] The 1995 law called for the abolition of all old arbitration commissions and the establishment of new arbitration commissions, independent in principle, yet licensed and recognized by the state, to arbitrate economic disputes.[80]

The Shanghai Arbitration Commission was established in 1995. However, the arbitration commission in Nanjing, the capital of one of the wealthiest coastal provinces, was not established until 1998. In the first five years (combined) following passage of the law, all domestic arbitration commissions nationwide accepted only 17,000 cases, involving 25.7 billion rmb.[81] This compares to 1,329,020 strictly economic contract disputes involving 413.4 billion rmb accepted by courts in one year alone (1998). Table 7.2 shows the small number of cases handled by the Shanghai Arbitration Commission during its first five years; the commission handled only 189 cases in 1998, increasing to 649 cases in 2003. In the Nanjing and Shanghai survey, some respondents had arbitration clauses in their contracts, but many fewer used them.

Arbitration requires the agreement of both parties. Moreover, many standard form contracts contained imprecise clauses like the following: "All disputes arising from this contract should be resolved through direct negotiation. If direct negotiation is unsuccessful, the parties can apply for arbitration through the arbitration commission or sue in the court (*youbenhetong yinqide yiqiezhengyi youshuangfang xieshangjiejue. xieshangbucheng, buchengbili shuangfangjunkexiang zhongcaijigou shengqingzhongcai huoxiangfayuan tichususong*)" (contract provided by Enterprise #1). When a specific arbitration commission is named by one party to a contract, the other party is often suspicious of personal ties between the first party and the arbitrator. In the World Bank survey of 1,500 firms, only 12 percent used arbitration even once in the final resolution of disputes with suppliers or customers, and only 2 percent used arbitration at least half of the time (figures 7.7 and 7.8). In the Nanjing and Shanghai sample, most respondents had little awareness or understanding of the potential role for arbitration. Only 17.6 percent of respondents mentioned it as a viable dispute resolution mechanism (figure 7.6). Comments like "Where is there an arbitration commission? (*na er you zhongcaiweiyuanhuei*)?" (Enterprise #16) were common. Furthermore, many respondents perceived it as less authoritative than the courts—despite the fact that, in principle, they could apply for enforcement of arbitral decisions by the courts in the same way that they could for court decisions.

Table 7.2. Shanghai Arbitration Commission

	Number of Cases	*Total Value of Contracts in Dispute (10,000 rmb)*	*Average Value of Contracts in Dispute (rmb)*
1998	189	27,180	1,438,109
1999	253	58,570	2,315,024
2000	341	36,400	1,067,449
2001	431	72,030	1,671,230
2002	479	57,879	1,208,330
2003	649	128,833	1,985,100
Avg Growth	22.8	29.6	5.5

Source: Shanghai Arbitration Commission, August 2004

What is noteworthy, however, is the relatively large value of contracts in dispute brought to the Shanghai Arbitration Commission—roughly 1.5 million rmb on average in 1998 (table 7.2), compared to an average value of only about 300,000 rmb for economic contract disputes in the courts (nationwide) in that year.

In the Shanghai and Nanjing sample, managers of large state-owned enterprises (SOEs) accounted for fully two-thirds of the small share of responses identifying arbitration as a viable dispute resolution mechanism.[82] Given the prominence of arbitration among foreign firms, I would have expected the Sino-foreign joint ventures in the sample to choose arbitration disproportionately. However, the prominence of large SOEs among those indicating arbitration commissions as a viable option may be due to their earlier experience with arbitration by the Economic Contract Arbitration Commission under the State Administration for Industry and Commerce.[83]

Litigation

Between 1983 and 2001, economic disputes, broadly defined, accepted by the court of first instance increased at an average annual rate of 18.8 percent, peaking in 1999[84] (table 7.1). Put in wider domestic context, civil disputes increased at less than half that rate on average—8.3 percent per year over the same period—while criminal cases grew at only 4.7 percent per year on average. Data for administrative cases is available only for the period 1987–2001,

Table 7.3. Economic Contract Disputes Handled in the Courts of First Instance

	Number of Cases Accepted	*Total Value of Contracts in Dispute (10,000 rmb)*	*Average Value of Contracts in Dispute (rmb)*	*Change in Average Value*	*Change in Number of Cases Accepted*
1983	36,274	171,055	51,541		
1984	69,204	149,659	24,443	−52.6	90.8
1985	206,582	897,804	48,611	98.9	198.5
1986	292,599	788,339	28,144	−42.1	41.6
1987	332,496	814,621	24,552	−12.8	13.6
1988	467,872	1,110,392	25,033	2.0	40.7
1989	634,941	1,935,130	31,426	25.5	35.7
1990	543,613	1,731,293	31,277	−0.5	−14.4
1991	516,507	1,987,858	37,101	18.6	−5.0
1992	598,610	2,970,257	49,878	34.4	15.9
1993	824,448	6,342,211	77,834	56.0	37.7
1994	971,432	9,727,423	100,875	29.6	17.8
1995	1,184,377	14,830,833	125,865	24.8	21.9
1996	1,404,921	21,406,425	153,641	22.1	18.6
1997	1,373,355	26,303,090	192,336	25.2	−2.2
1998	1,329,020	41,343,216	310,167	61.3	−3.2
1999	1,410,107	n/a	n/a	n/a	6.1
2000	1,184,613	n/a	n/a	n/a	−16.0
2001	1,062,302	n/a	n/a	n/a	−10.3

Notes:
As of 1998, statistics on economic contract disputes accepted by the courts include cases involving foreign entities.
As of 1988, statistics on cases involving transport of goods were removed from the larger category of economic contract disputes.
Sources: *Quanguo renming fayuan sifa tongji lishi ziliao huibian 1949-1998 (Mingshi bufen)*, 2000 (Beijing: renming fayuan chubanshe); Zhongguo falu nianjian, various years.

and only administrative cases outpaced the growth of economic dispute cases, increasing at an average annual rate of 21.8 percent from a small base. While it is difficult to specify a meaningful metric for evaluating the pace of growth, the courts appear to play an increasingly important role in economic disputes during the reform period.

Contract dispute litigation in particular, which accounts for the lion's share (more than 90 percent) of all economic dispute cases accepted by the courts, increased at an average annual rate of 20.1 percent between 1983 and 2001. A definitional change means that data for the years 2002 to 2006 is not strictly comparable with earlier years. Moreover, data on the average value of disputes is available only through 1998: from 1983 to 1998, the total value of disputes grew 40.9 percent per year on average, while the average value of disputes grew at 11.9 percent per year on average. In 1998, the average value of a contract dispute heard in the courts nationwide was 310,167 rmb (table 7.3). As noted above, the average value of arbitrated cases was much larger, but the number of disputes heard by arbitration commissions was miniscule in comparison.[85] In China, as elsewhere, litigation of contract disputes is rarely the first resort.[86] Nevertheless, in the World Bank survey of 1,500 firms in the year 2000, 38.8 percent of firms used litigation in the final resolution of disputes with at least one client, while 29.8 percent used litigation in the final resolution of disputes with at least one supplier (figures 7.7 and 7.8). In the study of seventy-six firms in Shanghai and Nanjing, 36.8 percent of respondents had used the courts in their *most recent* dispute.

As with litigation of economic disputes more broadly, litigation of contract disputes peaked in 1999, declined slightly and leveled off since. In interpreting the reasons for the peak (1996–1999) and subsequent decline in litigation of contract disputes, judges in district and intermediate courts in Shanghai identified several factors with a lagged effect (Interview sh040721p; sh040817p). They include the prevalence of oral contracts, which are more likely to end up in court; the tightness of macroeconomic policy, which contributes to the incidence of nonpayment disputes; the pace of transition from plan to market; and the pace of transformation of state-owned enterprises.

Oral contracts are more likely to end up in litigation and may have been more prevalent in the mid-1990s. In the World Bank survey of 1,500 firms in the year 2000, less than 10 percent of contracts with clients were oral, and less than 20 percent of contracts with suppliers were oral. Yet, in the Nanjing court sample, more than 40 percent of the court cases between 1999 and 2001 involved oral contracts. This finding suggests a greater propensity to litigate oral contracts.

The transition from plan to market, most notably in terms of the transformation of small- and medium-sized state-owned enterprises, may have

generated a transitory wave of disputes. Indeed, anecdotal evidence suggests that nonpayment disputes may move from multiple renegotiations of payment terms to litigation when new owners repudiate debt (interview Enterprise #77). Another practice that occurs during enterprise restructuring is the concentration of valuable assets in one spin-off, leaving the debts; it is then difficult to recover any amount owed by the original firm (interview with lawyer nj020925p). Litigation is also a strategy for verifying outstanding accounts payable. One case record in the Nanjing court sample indicates that despite "a long-term cooperative relationship," the dispute was propelled into litigation by the fact that the plaintiff was facing restructuring (Nanjing Case #5). Similarly, according to Zhou et al., "One manager in a state-owned firm said: 'We use formal contracts and sometimes take our contractual partners to court. Most of the time we do not expect to get any tangible outcome from court decisions. But court decisions will put it on record that the contract failures are not the result of our irresponsibility or acceptance of bribes.'"[87] A practicing lawyer in Shanghai confirmed the propensity of SOEs to use the courts to verify the status of accounts (interview with lawyer sh040818p).

Lawyers and managers alike pointed to the substantial number of disputes arising from chains of unpaid "triangular debts (*sanjiaozhai*)," which increase when the state-run banking system tightens the credit supply (interview with lawyer nj020935p). Although tight macroeconomic policies also contribute overall to the high incidence of nonpayment disputes, private enterprises are much more strategic with respect to the likely outcome of the case; in other words, they are motivated by the expected value of suing. They are more likely to sue in case of nonpayment if they believe that the plaintiff has resources that can be captured or, in case of nonperformance, if they believe that the plaintiff can perform (interview with lawyer sh040818p). Indeed, the manager of a real estate development company in Shanghai commented, "One shouldn't sue like Qiu Ju did. . . . One shouldn't pursue matters in which one can obtain only justice/winning and not material gains (*buyaoxiang Qiu Ju nayang daguansi; zhengqi buzhengcaideshibuzuo*)" (Enterprise #11).[88] This view was confirmed by a partner in a Nanjing law firm; in fact, he evaluated not only the likelihood of winning but also the likelihood of the defendant's paying up before accepting new cases (interview with lawyer nj020925p).[89]

Supply of Legal and Judicial Services

Recourse to the courts is supported by the increasing supply of legal services. Indeed, in Nanjing and Shanghai, 91.6 percent of managers surveyed indicated that they had legal representation. Such representation took a range of forms, from legal departments internal to the firm, to retained counsel, to

Table 7.4. Supply of Legal Services

Year	Law Firms (Units)	Lawyers (Individuals)	Law Firms (% increase)	Lawyers (% increase)
1997	8441	98902		
1998	8946	101220	6.0	2.3
1999	9144	111433	2.2	10.1
2000	9541	117260	4.3	5.2
2001	10225	122585	7.2	4.5
2002	10873	136684	6.3	11.5
2003	11593	142534	6.6	4.3
2004	11823	145196	2.0	1.9
2005	12988	153846	9.9	6.0
Avg Growth	4.9	5.0		

Source: *Zhongguo falu nianjian,* various years.

lawyers hired on an as-needed basis. Judges similarly report that most parties to contract disputes come to court with legal representation (interview with judges).[90] Underpinning this representation is the expansion of the legal profession. The number of both lawyers and law firms has increased at an average annual rate of 4–5 percent since the mid-1990s, when such data became available (table 7.4). More strikingly, law is among the fastest growing undergraduate majors, increasing at an average annual rate of 20 percent between 1994 and 2006; at the graduate level, it is the fastest growing field, increasing at an average annual rate of 23 percent per year (table 7.5.) Information available for the year 2000 indicates that 185,169 people sat for the bar, while 21,700 attained the passing score of 231 points, yielding a pass rate of 10.05 percent.[91]

Trends in the number of judges show different characteristics, however. As of October 2004, there were 3,133 basic-level people's courts with 148,555 judges (*faguan*), of which 91,099 were front-line judges (*yixian faguan*; i.e., those hearing cases), a reduction of 13.07 percent from 2000.[92] Published reports suggest that the reduction may reflect a new emphasis on training and appropriate educational attainment. Those judges deemed unqualified may be removed from the courtroom.[93]

Judgments and Their Enforcement

Three major trends in the national data (1983–2001) on the disposition of economic contract disputes by the court bear on the issue of enforcement of court judgments[94] (table 7.6). First, withdrawals of cases by the plaintiffs have increased from approximately 8 percent in the mid-1980s to more than

Table 7.5. **Expansion of Legal Education**

	Philosophy	*Economics*	**Law**	*Education*	*Literature*	*History*	*Sciences*	*Engineering*	*Agriculture*	*Medicine*	*Admin.*	*Total*	*Law Share*
Graduates at the Bachelor's Level													
1994	2117	80,981	**17650**	35,234	92,928	16794	87,845	228,922	27,856	47,090	n/a	637,417	2.77
1995	2110	119,042	**23170**	41,898	115,969	18117	100,566	295,839	32,975	55,711	n/a	805,397	2.88
1996	1960	127,018	**25852**	40,620	120,051	16423	97,260	315,005	33,032	61,417	n/a	838,638	3.08
1997	1183	132,988	**28270**	39,595	116,115	14559	90,513	314,418	30,190	61,239	n/a	829,070	3.41
1998	1183	132,900	**29649**	40,716	119,583	14179	92,729	308,574	28,941	61,379	n/a	829,833	3.57
1999	1067	134,258	**31500**	40,271	120,957	13374	90,395	326,180	28,070	61,545	n/a	847,617	3.72
2000	916	159,299	**44124**	42,052	146,997	13661	98,200	354,291	30,370	59,857	n/a	949,767	4.65
2001	925	57,254	**61474**	52,563	157,837	10220	115,829	349,097	28,543	62,638	139,943	1,036,323	5.93
2002	1012	65,942	**79966**	79,812	198,535	11683	131,494	459,842	36,284	79,500	193,239	1,337,309	5.98
2003	1196	88,181	**110416**	117,072	286,889	13905	173,031	644,106	50,057	111,356	281,283	1,877,492	5.88
2004	1331	113,687	**133364**	146,685	367,133	14502	207,490	812,148	59,564	154,187	381,061	2,391,152	5.58
2005	1275	162,977	**163529**	280,134	415,206	10694	164,867	1,090,986	69,531	202,577	506,180	3,067,956	5.33
2006	1417	203,957	**186164**	322,317	524,806	10605	197,231	1,341,724	77,177	253,252	656,058	3,774,708	4.93
Avg Growth	−3.0	7.4	**19.9**	18.6	14.2	−3.5	6.4	14.6	8.2	13.8	29.4	14.7	
Graduates at the Master's and Doctorate Levels													
1994	454	1,967	**1,296**	540	1,575	506	5,521	12,463	945	2,780	n/a	28,047	4.62
1995	460	2,165	**1,370**	577	1,607	593	6,039	14,675	1,111	3,280	n/a	31,877	4.30
1996	581	3,666	**1,864**	736	2,228	745	6,646	17,621	1,418	4,144	n/a	39,649	4.70
1997	664	4,988	**2,258**	902	2,584	926	7,625	19,918	1,788	4,886	n/a	46,539	4.85
1998	659	4,740	**2,385**	893	2,795	859	7,473	20,681	1,715	4,877	n/a	47,077	5.07
1999	649	6,302	**3,257**	1,008	3,310	970	8,251	23,369	1,949	5,605	n/a	54,670	5.96
2000	775	7,308	**3,820**	1,221	3,714	1,026	8,077	24,378	2,282	6,166	n/a	58,767	6.50
2001	904	3,981	**4,504**	1,550	4,193	1,179	8,637	24,873	2,136	6,992	8,860	67,809	6.64
2002	n/a	n/a	**5,139**	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	80,841	6.36
2003	1,562	6,578	**7,484**	2,764	7,426	1,926	13,220	41,337	3,849	12,207	12,738	111,091	6.74
2004	1,854	8,098	**11,097**	4,276	10,483	2,407	17,540	56,074	5,165	16,128	17,655	150,777	7.36
2005	2,249	10,930	**14,103**	5,101	13,314	2,657	22,028	72,941	6,038	19,405	20,962	189,728	7.43
2006	3,117	14,784	**19,413**	767	20,107	3,497	29,137	94,516	8,853	26,415	28296	255,902	7.59
Avg Growth	16.0	16.8	**23.1**	22.8	21.6	16.0	13.7	16.9	18.8	18.9	21.4	18.5	

Sources: China Statistical Yearbook on Science and Technology (Beijing: China Statistics Press, 2000), p. 9;
Educational Statistics Yearbook of China (Beijing: People's Education Press, various years).

Table 7.6. **Disposition of Economic Contract Disputes by the Courts of First Instance (Share of Total)**

	Accepted	*Mediated by Court*	*Decided by Court*	*Transferred to Relevant Bureau*	*Rejected*	*Withdrawn*	*Resolved*	*Other*	*Total*
1983		79.3	5.5	4.2		8.5	2.4		100.0
1984		80.6	5.6	3.2		8.7	1.9		100.0
1985		81.8	5.7	3.1		8.5	0.9		100.0
1986		79.6	7.5	3.9		8.2	0.8		100.0
1987		77.3	9.5	2.8		9.6	0.8		100.0
1988		80.2	8.6	1.9	0.0	8.8	0.5		100.0
1989		76.8	10.5	2.0	0.0	10.2	0.5		100.0
1990		69.5	14.7	2.1	0.0	13.0	0.7		100.0
1991		61.6	20.0	2.2	0.0	14.7	1.5		100.0
1992		61.7	20.8	1.6	0.5	14.8	0.7		100.0
1993		63.1	19.5	1.5	0.3	14.9	0.6		100.0
1994		60.0	20.8	1.5	0.3	16.8	0.6		100.0
1995		57.7	22.1	1.3	0.3	17.9	0.6		100.0
1996		53.7	25.5	1.3	0.3	18.4	0.8		100.0
1997		49.9	29.1	1.5	0.4	18.3	0.8		100.0
1998		43.2	34.6	1.4	0.6	18.8	0.4	1.0	100.0
1999		41.3	35.5	0.0	0.8	19.3	0.0	3.1	100.0
2000		34.6	40.3	0.0	1.3	20.7	0.0	3.2	100.0
2001		30.8	43.8	0.0	1.4	21.3	0.0	2.7	100.0
2002		27.4	45.3	0.8	1.5	23.4	0.3	1.4	100.0
2003		26.5	44.8	0.8	1.6	24.4	0.2	1.6	100.0
2004		28.0	42.4	0.8	1.8	25.5	0.3	1.3	100.0
2005		28.7	41.3	0.9	1.6	26.3	0.3	1.1	100.0
2006		28.4	41.4	0.8	1.4	26.9	0.2	0.8	100.0

Source: *Quanguo renming fayuan sifa tongji lishi ziliao huibian 194—1998 (Mingshi bufen)*, 2000 (Beijing: renming fayuan chubanshe).

27 percent in 2006. Interviews with lawyers and enterprise managers suggest that the threat of litigation is just another step in the bargaining process; initiating litigation is one strategy to elicit performance from the contractual partner. Firms thereby make a credible threat to use the courts and then bargain within the "shadow of the law."[95] Settlement is often cheaper than litigation. In the Nanjing court sample, 29 percent of the cases (n = 22/76) were withdrawn; in general, these cases receive no further notation. However, in a few instances, court records include notations such as "defendant already paid" (Case #36) and "performed contract" (Case #27), indicating that bargaining in the shadow of the law can be effective.

In a second major trend, a higher percentage of cases nationwide go all the way to judgment than in the past, increasing from roughly 5 percent in the 1980s to more than 40 percent in 2006. Third, and relatedly, the data show declines in the occurrence of court-mediated settlements from roughly 80 percent of the total in the mid-1980s to 28 percent as of 2006. The decline is significant, since official interference has been reported to occur often during court-sponsored mediation. According to Pittman Potter, "The dominance of consensual methods of resolution [including court-sponsored mediation] permitted the personal and organizational relationships of the parties to affect the outcome, thus undermining contract autonomy."[96] However, interviews with lawyers, judges, and enterprise owners and managers in Shanghai and Nanjing confirm the decline in court-sponsored mediation.

Based on the Shanghai and Nanjing survey, it appears that court-sponsored mediation involving government officials occurs most commonly when fulfillment of unpaid contractual obligations may result in lay-offs or nonpayment of wages by an enterprise in difficulty. Such government intervention may reflect the priority of the Wen Jiabao administration on more timely payment of migrant labor wages. In this situation, judges may proactively invite government officials to participate in court-sponsored mediation, pressuring the plaintiff to accept smaller or delayed settlement in order to maintain the work force of the defendant (interview with district and intermediate court judges sh040817p).[97] In this regard, judges are like other government officials and bear political responsibility for any incidents affecting social stability. When the enterprise in difficulty is a state enterprise, the State Assets Commission (*guoziwei*) and the labor bureau are typically the state agencies brought in to the court-sponsored mediation process (ibid.). As a Nanjing lawyer commented, "Enterprise workers may resist implementation [of a judgment]; moreover, the enterprise and the workers may combine to hinder implementation even with covert support from the local government. If a large enterprise collapses, there is an impact on the local economy, the firm, and the workers" (interview nj020925p). Overall, however, the decline in court-sponsored mediation reduces one source of opportunity for official interference in court actions, and government interference was not a major complaint of managers who had taken contract disputes to court.[98]

Enforcement of judgments is an on-going problem. In March 2004, Xiao Yang, President of the China's Supreme People's Court, stated in his work report to the NPC, "The difficulty of executing civil and commercial judgments has become a major 'chronic ailment,' often leading to chaos in the enforcement process; there are few solutions to the problem."[99] According to Ge Xingjun, head of the SPC's Judgment Enforcement Division, approximately 60 percent of civil and economic judgments were enforced at the basic-level court, 50 percent at the intermediate-level court, and 40 percent at the provincial high-level court.[100] In general, inadequate data are available to assess the nature of implementation, but the Nanjing court sample sheds some light on this issue.[101] Of the seventy-six cases in the sample, 29 percent (n = 22/76) were withdrawn by the plaintiff; court-sponsored mediation occurred in 21 percent (n = 16/76) of the cases; and cases went to judgment in 47 percent of the cases (n = 36/76).

The latter two types of cases (68 percent of the total, n = 52/76) are subject to enforcement by the courts. Of the cases subject to enforcement, in only 3.8 percent (n = 2/52) were judgments "automatically" implemented. In 52 percent of the cases (n = 27/52), winners applied for compulsory enforcement (*qiangzhi zhixing*), and the vast majority of these applications came from cases that went all the way to judgment.[102] Only five of the cases resolved by court-sponsored mediation applied for compulsory enforcement, and one might presume that implementation was smoother in mediated outcomes in which creditor plaintiffs did not apply for compulsory enforcement. Of the twenty-seven cases that sought compulsory enforcement, the records indicate results for twenty of them, showing that 55.5 percent (n = 15/27) were implemented successfully and 18.5 percent (n = 5/27) failed to be implemented. Notations accompanying "successfully" implemented cases include, "Defendant paid debt by handing over factory land and equipment" (Case #52); "No assets to be implemented, except 5500 rmb attachment and auction" (Case #57); and "Defendant paid 3,350 rmb and a case of cigarettes; case closed" (Case #61). In most of the failed cases, records indicate that either there were no assets to be implemented (Cases #116, 23, 39) or the defendant was already in bankruptcy proceedings (Case #1). In the remaining case, the records indicate that a Shandong Province court rejected implementation of a Nanjing, Jiangsu Province judgment (Case #10).

Local protectionism—the failure of local courts to enforce judgments by outside courts on local firms—is a common explanation for failed implementation.[103] Locally, implementation branches of the courts can be more proactive; in Shanghai, the economic courts even engage in public shaming, periodically publishing the names of those who have unenforced judgments against them in a popular evening newspaper.[104] Shanghai court representatives also report organizing "enforcement delegations," which travel as a group to other provinces to seek—often unsuccessfully—enforcement of their judgments. Donald Clarke notes that the Chinese legal system may have a lower tolerance for nonimplementation of judgments than other societies, notably the United States.[105] Indeed Martin Shapiro writes,

> In most societies courts have had only the most rudimentary enforcement mechanisms. . . . Courts typically do not monitor compliance, and they reintervene to exact compliance only at the request of one of the parties. The reintervention often takes the form of a simple repetition of the previous order. The successful suitor even in a modern industrial society frequently finds that the decree is only the first in a long series of painful, expensive, and often inconclusive steps aimed at getting his remedy. Courts, we are repeatedly and rightly told, have neither the purse nor the sword.[106]

Private Coercion

In light of the lack of success of formal enforcement efforts, and in light of the attention received by mafia enforcement in other transition economies—most notably Russia—one might expect a greater role for private enforcement in China.[107] In the Nanjing and Shanghai sample, only 2.6 percent of firms reported resorting to private coercion to enforce contracts. In one case, a Shanghai manager described "resolving" a nonpayment dispute by "splitting the amount owed 50-50 with a gang (literally, "black society") (*"heishehuei yaoshoujioufen jin e de baifenzhiwushi zuowei shouduanfei"*), which then forcibly collected the money owed (Enterprise #1).[108] In another case, a manager in the food service industry used the biggest men in the warehouse to intimidate a recalcitrant business partner, who, in the manager's view, had supplied a defective refrigerator. The warehouse workers exacted money from the supplier to recover the original price of the refrigerator (Enterprise #12). Some managers alluded to privately engaging local police and splitting the payments recovered. As one lawyer noted, "There are many different illegal methods. For example, in Zhejiang [Province], some private bosses will put their lives on the line to get their money (*feifalushouduan jiouhenduole. biruzai Zhejiang, yixiesiyinglaoban, tamenpinleming yeyaobaqian zhueihueilai*)" (interview with lawyer nj020925p). However, private enforcement appears to be employed in a small number of disputes.[109]

Attitudes toward the Legal System

Courts appear to play a role in contract disputes because they are seen as authoritative (despite problems with enforcement), but not necessarily fair or just. According to one private business owner interviewed in Nanjing, "Going to court is not because it's fair but rather because it's authoritative (*zhaofayuan bushiyinwei tagkongzheng ershiyinwei tadequanwei*)" (interview nj021127p). Strikingly, an intermediate court judge echoed this sentiment, "*xuyaoyige youquanderen laichuli; zueiyouquanweixing zueirongyijieshou; buyidingzueikongzheng; buyaobakongzheng zuoweibiaozhuen; guanjiandeshi jiejuewenti* (You need an authoritative person to handle [the dispute], and the resolution of the most authoritative person is the easiest to accept)" (interview sh040817p).[110] Somewhat surprisingly, attitudes toward the legal system as a whole are solid: 56.3 percent of respondents in Shanghai and Nanjing rated the legal system as average, while 25.3 percent found it to be low or very low, and 18.3 percent found it to be high or very high. Paraphrasing Shapiro, Hendley et al. wrote, "Submitting a dispute to the courts implies an acceptance of the legitimacy of the institution and a willingness to abide by its decision."[111] Thus, the courts play a key role as a third-party arbiter, while this role is undersupplied by other institutions in China and mutual trust among businesses appears low. The contrast with attitudes toward other business people's trustworthiness in contracting is noteworthy, since it is more negative: 42.9 percent of respondents found it to be average, while 53 percent found it to be low or very low, and only 4.1 percent found it to be high or very high. As one manager put it, "There's no trust to speak of. The Cultural Revolution destroyed the normal relations between people; there's no more mutual trust. Under the planned economy, one wouldn't even call it trust; just irresponsibility. The situation of trust is pretty bad (*meiyouxinyongkeyan. wengedapole renyurenzhijian zhengchangdeguanxi, buzaixianghuxinren. jihuajingjishiqi nabujiaoxinyong, shibufuzeren. xinyongzhuangkuanghencha*)" (Enterprise interview #39).

These findings do not imply that courts are free of corruption. Business owners and managers interviewed suggest that they held their lawyers responsible for entertaining judges and cultivating positive relationships with judges. At the same time, owners and managers recognized that both parties to a dispute would engage in this behavior, and they regarded the expenses involved as part of the "cost of doing business." As one manager

noted, "It's better than it was before, and in the future it will definitely be good; we've entered the WTO. The effectiveness of the courts is okay; in Nanjing, we're set with respect to justice. When the company does business it considers legal factors relatively often (*biyiqianhao, yihouyekendinghao, womenjiaru shijiemaoyizuzhi. fayuandexiaolu haikeyi, zai Nanjing me, kongzhengxingfangmian womendougaodingle. kongsi zaizuoyewudeshihou kaolu falu yinsu bijiaoduo*)" (Enterprise interview #39). The reference to being "set" with respect to justice suggests an important investment in a good relationship with the court.

CONCLUSION

Weber and North may be incorrect to the extent that they claim that well-functioning legal institutions are a *prerequisite* for economic growth, but they are correct in identifying limits to the expansion of contracting in the absence of such institutions. Business people in urban China clearly seek recourse to the courts to underpin economic transactions. With respect to contract disputes—the most common type of economic dispute—courts are not as completely flawed as they have been portrayed, nor are disputants as nonlitigious as they have been portrayed. In the context of China's transition from socialism to a fast-growing market economy, contracts are often not grounded in social networks, but rather occur more at arm's length. Institutional alternatives to courts for underpinning contracts—mediation and arbitration—appear to be unavailable or are underdeveloped for local firms. At the same time, the role of the government bureaucracy in directly supervising contracts has declined markedly. In this context, the courts are an increasingly important element in the process of dispute resolution. But this role for the courts is by no means inevitable, as scholars like Pan Wei suggest.[112] The implementation of major policy changes, ranging from successive revisions of the body of law governing contracts to the training of legal professionals, are necessary in order for courts to play this role.

These findings have implications for broader arguments about the nature of the relationship between culture and institutions.[113] Many observers, drawing on the "normative tradition articulated by the Confucian elite,"[114] have concluded that litigation plays a minor role in East Asian societies.[115] Randall Peerenboom describes the Confucian tradition as follows:

> Confucius' politics of harmony requires the voluntary participation of the individuals who collectively comprise society. If conflicts arise, as they inevitably will, each person must evidence a willingness to look for a mutually acceptable solution. Of course a willingness to cooperate is not enough to overcome all conflicts. There must also be sufficient common ground to provide a basis for discussion, understanding, and potential mutually agreeable solutions. The li (rites) provide this essential communally owned repository of shared meaning and value on which to draw in times of conflict. One is inextricably a part of one's tradition. However different one may be from one's neighbor, there are still deep chords of affinity that bind one to other members of one's community. . . . The li are better understood as customary norms that . . . constitute . . . culturally valued, though negotiable, guidelines for achieving harmony in a particular context.[116]

However, Haley and Winn, among others, challenge the "myth of the reluctant litigant" by highlighting the *limited institutional capacity* of the courts and the legal professional in Japan, Taiwan, and Korea at levels of economic development comparable (or even more advanced) than China's today.[117] Peng describes these countries from the 1950s through the 1990s as "lawyerless wonderlands."[118] Haley, for example, focuses on the high barriers to entry to the bar—with a pass rate of 1.7 percent in 1975—and the lack of meaningful access to the courts: "The simplest trial can take over a year at the district court level, and the average is two years."[119] But, in contrast, he also highlights the ready supply of alternatives to the courts, such as private mediation companies. Haley concludes, "What distinguishes Japan [from most societies] is the successful implementation of this interdiction [to litigate] through institutional arrangements."[120]

In contrast to the experience of other Northeast Asian countries, China is rapidly expanding the supply of legal services at a much earlier stage of economic development. China—at a per capita income of about US $960.00 in 2002 compared to Korea's US $11,280.00—had one lawyer for every 9,510 people in that year, while Korea had one lawyer for every 9,383 people.[121] In 2004, Shanghai alone had more than 6,000 lawyers in 592 law firms, while Korea had 6,273 lawyers in 258 law firms nationwide.[122]

This contrast in the supply of legal services at a relatively early stage of economic development in China is most likely explained by the Chinese Communist Party's attempt to develop "rule of law" as a new means to both legitimate itself and promote continued rapid economic growth. In 1996, Jiang Zemin articulated the official policy of ruling the country in accordance with law and establishing a socialist rule of law state (*yifazhikuo jianshe shehueizhuyizhikuo*). These principles were enshrined in a constitutional amendment in 1999; the relevant article now reads, "The People's Republic of China exercises the rule of law, building a socialist country governed according to law." It is important to note that contract disputes not only are among the most common type of dispute, but are also among the least politically sensitive in the legal system;

thus, the present study is not directly generalizable to other, more directly political, types of disputes. Indeed, the state in urban China has removed itself to a large extent from day-to-day economic exchange, and an important part of the CCP's motivation for pursuing the "rule of law" is precisely to gain the economic benefits of a more market-oriented economy and deeper links to the international economy that are supported by reformed legal institutions.[123] Moreover, when contract disputes do become politically sensitive—as in the enforcement of judgments in nonpayment disputes that might result in large lay-offs affecting political stability, for example—the "rule of law" does not always hold sway, as demonstrated above. While the prominence of "rule of law" rhetoric in contemporary PRC politics may be instrumental to the goals of regime maintenance, it nevertheless has measurable implications for the development of legal institutions in the realm of economic exchange.

NOTES

1. The average annual rate of increase for 1983–1999 (the years for which strictly comparable data is available) is 24 percent. *Quanguo renming fayuan sifa tongji lishi ziliao huibian 1949–1998 (Mingshi bufen)*, 2000, Beijing: renming fayuan chubanshe; Zhongguo falu nianjian, various years. Donald C. Clarke, 1991, "Dispute Resolution in China," *Journal of Chinese Law,* Vol. 5, No. 2, pp. 245–296; Stanley Lubman, 1997, "Dispute Resolution in China after Deng Xiaoping: 'Mao and Mediation' Revisited," *Columbia Journal of Asian Law,* Vol. 11, No. 2, pp. 229–391; Stanley Lubman, 1999, *Bird in a Cage: Legal Reform in China after Mao*, Stanford, Calif.: Stanford University Press.

2. Katharina Pistor, and Philip A. Wellons (eds.), 1999, *The Role of Law and Legal Institutions in Asian Economic Development*, New York: Oxford University Press.

3. Max Weber, Guenther Roth, and Claus Wittich (trans.), 1978, *Economy and Society: An Outline of Interpretive Sociology,* Berkeley: University of California Press.

4. Douglass C. North, 1990, *Institutional Change and Economic Performance*, New York: Cambridge University Press.

5. Douglas C. North, 1992, "Institutions, Ideology and Economic Performance," *The Cato Journal*, Vol. 11, No. 3, p. 481.

6. Frank Upham, 1995, "Speculations on Legal Informality: On Winn's 'Relational Practices and the Marginalization of Law," *Law and Society Review,* Vol. 28, No. 2; John Gillepsie, 1999, "Law and Development in 'The Market Place': An East Asian Perspective," in Kanishka Jayasuriya (ed.), *Law, Capitalism, and Power in Asia: The Rule of Law and Legal Institutions*, London Routledge, pp. 118–150.

7. Stewart Macaulay, 1963, "Non-Contractual Relations in Business: A Preliminary Study," *American Sociological Review,* Vol. 28, No. 1, pp. 55–67.

8. Robert C. Ellickson, 1991, *Order Without Law: How Neighbors Settle Disputes*, Cambridge: Harvard University Press.

9. Jane Kaufman Winn, 1994, "Relational Practices and the Marginalization of Law: Informal Financial Practices of Small Businesses in Taiwan," *Law and Society Review,* Vol. 28, No. 2, pp. 193–232; Carol Jones, 1994, "Capitalism, Globalization and Rule of Law: An Alternative Trajectory of Legal Change in China," *Social and Legal Studies,* Vol. 3, pp. 195–221. While Winn and Jones address contracting and dispute resolution specifically, there is a much broader literature on social connections (*guanxi*) in Chinese societies. Among recent contributions, see, for example: Thomas Gold, Doug Guthrie, and David Wank, 2002, *Social Connections in China*, New York: Cambridge University Press; Gary H. Hamilton, 1996, *Asian Business Networks*, Berlin: Walter de Gruyter; Nan Lin, and Chih-jou Chen, 1994, "Local Initiatives in Institutional Transformation: The Nature and Emergence of Local Market Socialism in Jiangsu," Paper presented to the Annual Meeting of the Association of Asian Studies, Boston, March 24–27; Victor Nee, and Sijin Su, 1996, "Local Corporatism and Informal Privatization in China's Market Transition," in John McMillan and Barry Naughton (eds.), *Reforming Asian Socialism: The Growth of Market Institutions*, Ann Arbor, Mich.: University of Michigan Press, pp. 111–134; Yunxiang Yan, 1996, *The Flow of Gifts: Reciprocity and Social Networks in a Chinese Village*, Stanford, Calif.: Stanford University Press; and Mayfair Mei-hui Yang, 1994, *Gifts, Favors, Banquets: The Art of Social Relationships in China*, Ithaca, N.Y.: Cornell University Press.

10. Kathryn Bernhardt, and Philip C. C. Huang, 1994, *Civil Law in Qing and Republican China*, Stanford, Calif.: Stanford University Press. The work of Kathryn Bernhardt and Philip Huang (1994) has sparked debate regarding the role of law and the courts in the traditional Chinese legal system. They challenge the extent to which traditional China had a "non-litigious" culture that privileged harmonious relations over overt conflict and mediation over litigation. See also Diamant (2000), which draws on the work of Bernhardt and Huang. Neil J. Diamant, 2000, "Conflict and Conflict Resolution in China: Beyond Mediation-Centered Approaches," *Journal of Conflict Resolution,* Vol. 44, No. 4, pp. 523–596.

11. See Stanley Lubman, 1999, *Bird in a Cage: Legal Reform in China after Mao*, Stanford, Calif.: Stanford University Press; Lester Ross, 1990, "The Changing Profile of Dispute Resolution in Rural China: The Case of Zouping County, Shandong," *Stanford Journal of International Law,* Vol. 26, No. 1, pp. 15–66.

12. Donald C. Clarke, 1995, "The Execution of Civil Judgments in China," *China Quarterly,* No. 141, pp. 65–81; Donald C. Clarke, 1991, "Dispute Resolution n China," *Journal of Chinese Law,* Vol. 5, No. 2, pp. 245–296; Anthony Dicks, 1995, "Compartmentalized Law and Judicial Restraint: An Inductive View of Some Jurisdictional Barriers to Reform," *China Quarterly,* No. 141, pp. 82–109; Pitman B. Potter, 1992, *The Economic Contract Law of China*, Seattle: University of Washington Press; David Zweig, Kathy Hartford, James Feinerman, and Deng Jianxu, 1987, "Law, Contracts, and Economic Modernization: Lessons from the Recent Chinese Rural Reform," *Stanford Journal of International Law,* Vol. 23, No. 2, pp. 319–364.

13. Pan Wei, Beijing University, commentary presented at the International Conference on "Grassroots Democracy and Local Governance in China During the Reform Era," Chinese Association of Political Science and National Chengchi University,

Taiwan, November 2–3, 2004. This view was also evident in the early law and development literature, which was strongly influenced by modernization theory. "'Law' was seen as both a necessary element in 'development' and a useful instrument to achieve it" (David M. Trubek and Marc Galanter, 1974, "Scholars in Self-Estrangement: Some Reflections on the Crisis of Law and Development Studies in the United States," *Wisconsin Law Review*, No. 4, p. 1073). See also Tom Ginsburg, 2000, "Does Law Matter for Economic Development? Evidence From East Asia," *Law & Society Review*, Vol. 34, No. 3, p. 832. This paper adopts the view that there is nothing inevitable about the development of legal institutions.

14. John Haley, 1978, "The Myth of the Reluctant Litigant," *Journal of Japanese Studies*, Vol. 4, No. 2, pp. 359–390; Edward N. Muller, and Mitchell A. Seligson, 1994, "Civic Culture and Democracy: The Question of Causal Relationships," *American Political Science Review*, Vol. 88, No. 3, pp. 635–652; Sidney Tarrow, 1996, "Making Social Science Work Across Space and Time: A Critical Reflection on Robert Putnam's *Making Democracy* Work," *American Political Science Review*, Vol. 90, No. 2, pp. 389–397. *Institutions* here are defined as formal organizations (state or non-state) that set or embody rules shaping the behavior of their constituents; *culture* is defined as a relatively stable pattern of attitudes and values regarding, e.g., the political or legal system.

15. It is important to note that disputes over labor contracts are handled through a distinct set of laws and institutions. On labor disputes see Mary Gallagher, 2005, *Contagious capitalism: globalization and the politics of labor in China*, Princeton, N.J.: Princeton University Press; and Ching Kwan Lee, 2007, *Against the law: Labor protests in China's rustbelt and sunbelt*, Berkeley: University of California Press.

16. Kathryn Hendley, Peter Murrell, and Randi Ryterman, 2000, "Law, Relationships, and Private Enforcement: Transactional Strategies of Russian Enterprises," *Europe-Asia Studies*, Vol. 52, No. 4, pp. 627–656; Simon Johnson, John McMillan, and Christopher Woodruff, 2002, "Courts and Relational Contracts," *Journal of Law, Economics, and Organization*, Vol. 18, No. 1, pp. 221–277.

17. Neil J. Diamant, 2000, "Conflict and Conflict Resolution in China: Beyond Mediation-Centered Approaches," *Journal of Conflict Resolution*, Vol. 44, No. 4, pp. 523–546. On Japan, see T. Ginsburg, and G. Hoetker, 2006, "The Unreluctant Litigant? An Empirical Analysis of Japan's Turn to Litigation," *Journal of Legal Studies*, Vol. 35, pp. 31–59; and Veronica Taylor. Only a few years earlier, scholars bemoaned the lack of empirical research. Stanley Lubman lamented, "Most Western study has necessarily focused on the texts of the rules, which tell nothing about their impact on practice" (Stanley Lubman, 1999, *Bird in a Cage: Legal Reform in China after Mao*, Stanford, Calif.: Stanford University Press; p. 35). Minxin Pei describes the "paucity of empirically based scholarship on the actual operation of the emerging legal system," which he attributes to the poor access to relevant materials and to the small number of social scientists as opposed to lawyers engaged in such research. Minxin Pei, 2001, "Does Legal Reform Protect Economic Transactions? Commercial Disputes in China," in Peter Murrell (ed.), *Assessing the Value of Law in Transition Economies*, Ann Arbor: University of Michigan Press, pp. 180–210. See also William P. Alford, 2000, "Law, Law, What Law? Why Western Scholars of

China Have Not Had More to Say about Its Law," in Karen G. Turner, et al. (eds.), *The Limits of the Rule of Law in China*, Seattle: University of Washington Press, pp. 45–64. There were always exceptions to the general lack of empirical studies, of course, including Stanley Lubman's (1999) study of dispute resolution based not only on textual and institutional analysis, but also on formal and informal interviews and secondary literature in Chinese; Lester Ross' (1990) study of dispute resolution based on interviews conducted in a single county; Isabelle Thireau and Hua Linshan's (1997) analysis of 130 court cases from a basic-level civil court in single city; Phyllis Chang's (1989) case-study analysis of rural responsibility contract disputes; Thomas Lyons' (1994) analysis of rural disputes based on newspaper accounts; and Pei Minxin's (2001) analysis of cases reported in *Zhongguo shenpan anli yaolan* (*Anthology of Adjudicated Cases in China*). In other cases, path-breaking research, such as Randall Peerenboom's study of enforcement of arbitral awards based on the author's own snowball sample, focuses exclusively on cases involving foreigners, thus neglecting the domestic legal arena. Randall Peerenboom, 2001, "Seek Truth From Facts: An Empirical Study of Enforcement of Arbitral Awards in the PRC," *American Journal of Comparative Law*, Vol. 49, pp. 249–327. Moreover, work like that of Pei (1997; 2001), which is based on the *Zhongguo shenpan anli yaolan*, suffers from certain methodological problems. First, as Lubman (1999, 288) indicates, the source "is not representative of ordinary judicial decisions because it is a compilation of decisions submitted from courts all over China that have been chosen, edited, and often extensively rewritten by law professors before publication." Moreover, as Pei acknowledges, the cases in no way constitute a representative sample; there is no indication of any attempt by the editors to select cases that reflect the characteristics of the population of cases. Therefore, one cannot make descriptive inferences to the population based on the sample. For example, he states, "The data on the background of the litigants in the sample show that the majority of litigants are state-owned enterprises and government-affiliated nonprofit institutions" (2001, 201). Based on the available data, it cannot be shown that this statement accurately describes the population of cases. Melanie Manion's (1994) statistical study of unrepresentative samples suggests that, at best, one may use an unrepresentative sample to examine *relationships among variables*, so long as one can measure or estimate the bias in the sample and so long as that bias is not systematically related to either of the variables of interest in the relationship (Melanie Manion, 1994, "Survey Research in the Study of Contemporary China: Learning from Local Samples," *China Quarterly*, No. 139, pp. 741–765). Moreover, Manion looks specifically at unrepresentative *local* samples, which render estimation of the bias somewhat easier. Interviews conducted during the summer of 2001 with the editors and publishers of several case anthologies highlight the difficulty—if not impossibility—in assessing the bias in the sample of published cases.

18. Eighty percent of the firms are located in Nanjing; 20 percent in Shanghai. Twenty-one percent of firms are foreign (including foreign joint ventures), 21 percent private, 7 percent collective, and 48 percent state (including domestic joint ventures). Firms represent a wide range of manufacturing and service sectors, and firm size ranged from 8 to more than 10,000 employees.

19. World Bank, "Competitiveness, Technology and Firm Linkages in Manufacturing Sector, 1998-2000" (WDI ID 0359). "The dataset is created from a firm-level survey conducted by the World Bank in 2001. The survey covers 1,500 Chinese firms, which are evenly distributed across five big cities: Beijing, Chengdu, Guangzhou, Shanghai and Tianjin. The sample firms are drawn within ten sectors, of which five are manufacturing . . . and the other five are service sectors." The data cited here are for the year 2000.

20. Bing Ling, 2002, *Contract Law in China*, Hong Kong: Sweet & Maxwell Asia, p.14.

21. Regulations governing the use of contracts were first set forth in 1950 following the founding of the PRC state and the abolition of the ROC Civil Code and Nationalist law, then elaborated with the establishment of economic planning in the mid-1950s, and subsequently revived in the early 1960s during the retrenchment following the Great Leap Forward. They fell into disuse during the Cultural Revolution and were reintroduced in industry and agriculture in 1978 and 1979, respectively (Bing Ling, 2002, *Contract Law in China*, Hong Kong: Sweet & Maxwell Asia, p.11; Pitman B. Potter, 1992, *The Economic Contract Law of China*, Seattle: University of Washington Press, pp. 19–20). In 1979, the State Administration for Industry and Commerce was established and tasked with overseeing economic contracts, and in the same year economic divisions were put in place in the court system to hear economic disputes (Ling 2002: 11-12).

22. Liming Wang, and Xu Chuanxi, 1999, "Fundamental Principles of China's Contract Law," *Columbia Journal of Asian Law*, Vol. 13, No. 1, p. 3.

23. Bing Ling, 2002, *Contract Law in China*, Hong Kong: Sweet & Maxwell Asia, p. 43.

24. Pitman B. Potter, 1992, *The Economic Contract Law of China*, Seattle: University of Washington Press, p. 79.

25. Liming Wang, and Xu Chuanxi, 1999, "Fundamental Principles of China's Contract Law," *Columbia Journal of Asian Law*, Vol. 13, No. 1, p. 31.

26. Bing Ling, 2002, *Contract Law in China*, Hong Kong: Sweet & Maxwell Asia, p. 22.

27. A legal person is an entity other than a human being (e.g., a corporation) that is recognized by the legal system as having various capacities such as the ability to own property, bear liability, and undertake contractual commitments.

28. Pitman B. Potter, 1992, *The Economic Contract Law of China*, Seattle: University of Washington Press, p.32.

29. Bing Ling, 2002, *Contract Law in China*, Hong Kong: Sweet & Maxwell Asia, p.139; Pitman B. Potter, 1992, *The Economic Contract Law of China*, Seattle: University of Washington Press, p.87; Liming Wang, and Xu Chuanxi, 1999, "Fundamental Principles of China's Contract Law," *Columbia Journal of Asian Law*, Vol. 13, No. 1, p. 4.

30. Donald C. Clark, 1992, "Regulation and Its Discontents: Understanding Economic Law in China," *Stanford Journal of International Law*, Vol. 28, No. 2, pp. 282–322; He Rongfei, 1987, *Wenzhou jingji geju: women de zuofa he tansuoxing yijean (The Economic Structure of Wenzkou)*, Zhejiang: Zhejiang renmin chubanshe;

Susan H. Whiting, 2001, *Power and Wealth in Rural China: The Political Economy of Institutional Change*, New York: Cambridge University Press.

31. Susan H. Whiting, 2001, *Power and Wealth in Rural China: The Political Economy of Institutional Change*, New York: Cambridge University Press, p.150.

32. Susan H. Whiting, 2001, *Power and Wealth in Rural China: The Political Economy of Institutional Change*, New York: Cambridge University Press, p.150.

33. Susan H. Whiting, 2001, *Power and Wealth in Rural China: The Political Economy of Institutional Change*, New York: Cambridge University Press, p. 141.

34. Zhang, Houyi, and Qin Shaoxing, 1989, "pinyin title" ("The Current Situation of Development of Private Enterprises with One Million Yuan in Assets and Policy Responses"), *Journal title in pinyin* (Economic Research Reference Materials), No. 39, reprinted in "pinyin title" (*Reprinted Periodical Materials – Economic System Reform)*, 1989, No. 6, pp. 59–67.

35. Bing Ling, 2002, *Contract Law in China*, Hong Kong: Sweet & Maxwell Asia, p. 14.

36. Bing Ling, 2002, *Contract Law in China*, Hong Kong: Sweet & Maxwell Asia, p. 140.

37. Liming Wang, and Xu Chuanxi, 1999, "Fundamental Principles of China's Contract Law," *Columbia Journal of Asian Law*, Vol. 13, No. 1, p. 10.

38. As Ling (2002:43) indicates, the principle put forward in the CL is "voluntariness," but the "substantive rights recognized under the principle of voluntariness are almost identical to those under the conventional notion of freedom of contract."

39. Bing Ling, 2002, *Contract Law in China*, Hong Kong: Sweet & Maxwell Asia, p. 49.

40. Wai-keung Chung, and Gary H. Hamilton, 2001, "Social Logic as Business Logic: Guanxi, Trustworthiness, and the Embeddedness of Chinese Business Practices," in Richard Appelbauj, et al. (ed.), *The Legal Culture of Global Business Transactions*, Oxford: Hart Publishing, p. 325.

41. Thomas Gold, Doug Guthrie, and David Wank, 2002, *Social Connections in China*, New York: Cambridge University Press; and Chung and Hamilton (2001) provide good reviews of the massive literature on this topic.

42. Victor Nee, and Sijin Su, 1996, "Local Corporatism and Informal Privatization in China's Market Transition," in John McMillan and Barry Naughton (eds.), *Reforming Asian Socialism: The Growth of Market Institutions*, Ann Arbor: University of Michigan Press, pp. 111–134.

43. Nan Lin, and Chih-jou Chen, 1994, "Local Initiatives in Institutional Transformation: The Nature and Emergence of Local Market Socialism in Jiangsu," Paper presented to the Annual Meeting of the Association of Asian Studies, Boston, March 24–27.

44. Abromse King, 1991, "Kuan-his and Network Building: A Sociological Interpretation," *Daedalus*, Vol. 120, No. 2, p. 79.

45. Doug Guthrie, 1999, *Dragon in a Three-Piece Suit: The Emergence of Capitalism in China* , Princeton, N.J.: Princeton University Press; Lisa A. Keister, 2002, "Guanxi in Business Groups: Social Ties and Formation of Economic Relations," in Thomas Gold, et al., (eds.), *Social Connections in China*, New York: Cambridge

University Press, pp. 77–96 ; Susan H. Whiting, 1998, "The Mobilization of Private Investment as a Problem of Trust in Local Governance Structures," in Valerie Braithwaite and Margaret Levi (eds.), *Trust and Governance*, New York: Russell Sage Foundation, pp. 167–193; and Susan H. Whiting, 2001, *Power and Wealth in Rural China: The Political Economy of Institutional Change*, New York: Cambridge University Press.

46. Avner Greif, 1989, "Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Trader," *Journal of Economic History*, Vol. 49, No. 4, pp. 857–882; Janet Landa, 1981, "A Theory of the Ethnically Homogenous Middleman Group: An Institutional Alternative to Contract Law," *Journal of Legal Studies*, Vol. 10, No. 2, pp. 349–362.

47. Zhou Xueguang et al., 2003, "Embeddedness and Contractual Relationships in China's Transitional Economy," *American Sociological Review*, Vol. 68, No. 1, pp. 75–102. This study of contracting behavior is based on a convenience (non-random) sampling method and includes 620 firms in Beijing and Guangzhou.

48. Xueguang et al. indicate the difficulty of separating networks that arise from social ties as opposed to business contacts. The present study attempts to distinguish relationships that originate in business contacts from those that have their origins among family and friends. Ibid.

49. Xueguang et al., 2003, "Embeddedness and Contractual Relationships in China's Transitional Economy," *American Sociological Review*, Vol. 68, No. 1, p. 91.

50. Xueguang et al., 2003, "Embeddedness and Contractual Relationships in China's Transitional Economy," *American Sociological Review*, Vol. 68, No. 1, p. 96.

51. Enterprise #35.

52. Interview with lawyer sh040818p.

53. Interview with trade association representative sh040827.

54. This apparently more positive assessment of the role of trade associations in underpinning contractual relations may be a function of wording. The World Bank survey asked managers to respond to queries about the functions of associations "in regards to general members, not only to your firm in particular."

55. Interview with lawyer nj020925p.

56. Alex Xu, 2002, "First Personal Credit Law Expected Early Next Year," China Internet Information Center December 20, 2002, http://www.china.org.cn.

57. "*duobanminshangshipanjue xuqiangzhizhixing mingezhongyangjianyi sifagaige* (More than half of judgments in civil commercial matters need compulsory enforcement)," http://news.tom.com/1002/20050707-2285205.html.

58. "*kuowuyuan bankongting guanyu shehueixinyongtixi jianshederuokanyijian* (Several Opinions Regarding Building a Social Credit System) *kuobanfa* [2007]#17," http://www.gov.cn/zwgk/2007-04/02/content_569314.htm.

59. Personal communication, Donald Clarke, Faculty of Law, George Washington University, October 2004.

60. Su Ning, 2004, "Fostering Modern Credit Culture in China," speech delivered to the International Conference on "Public Policy for Credit Reporting Systems," September 28, 2004, http://www.pbc.gov.cn. Subsequent speeches document the developments to date: Su Ning, 2006, "Major Progress in the Building of a Credit Registry System in China," *BIS Review* (October 2006); and Su Ning, 2007, "The Evolution of a Credit Information System for China," *BIS Review* (December 2007).

61. This is a preliminary finding based on coding of eighteen out of seventy-six transcripts of open-ended interview questions.

62. Despite China's gradual approach to market transition, which, beginning in 1984, allowed the coexistence of plan-administered contracts and market transactions, most exchanges were taking place in the market by 1992. More than a decade later in the early twenty-first century, government is no longer directly underpinning contracts through the economic plan, and even informal contacts introduced through government bureaus are increasingly rare. Indeed, figure 7.1 shows that, in Shanghai and Nanjing, only 8.6 percent of firms reported finding suppliers through government contacts, and only 10 percent reported finding customers this way (figure 7.2). Zhou et al. (2003) also find that government sources play a minor role in the search for contracting partners, accounting for only 6.6 percent.

63. Kathryn Hendley, Peter Murrell, and Randi Ryterman, 2000, "Law, Relationships, and Private Enforcement: Transactional Strategies of Russian Enterprises," *Europe-Asia Studies*, Vol. 52, No. 4, p. 629.

64. Max Rheinstein (ed.), 1954, *Max Weber on Law in Economy and Society*, Cambridge, Mass.: Harvard University Press, pp. 29–30.

65. (Enterprise #39).

66. Kathryn Hendley, Peter Murrell, and Randi Ryterman, 2000, "Law, Relationships, and Private Enforcement: Transactional Strategies of Russian Enterprises," *Europe-Asia Studies*, Vol. 52, No. 4, pp. 627–656; Oliver Williamson, 1985, *The Economic Institutions of Capitalism*, New York: Free Press.

67. Enterprises #61, 66, 69, 75, 1.

68. Interview with lawyer nj020935p.

69. This is often the case in the United States as well. Daniel Keating, 1997, "Measuring Sales Law against Sales Practice: A Reality Check," *Journal of Law and Commerce*, Vol. 17, No. 1, p. 125.

70. Enterprise #29.

71. Interview with lawyer nj020925p.

72. Interview with lawyer nj020925p.

73. Stanley Lubman refers to economic dispute mediation centers (*jingji jioufen tiaojie zhongxin*) during the early 1990s, but it is not clear how widespread they were, and they do not appear in accounts of mediation offered by managers in Shanghai and Nanjing (Stanley Lubman, 1999, *Bird in a Cage: Legal Reform in China after Mao*, Stanford, Calif.: Stanford University Press, pp. 276–277).

74. Stanley Lubman, 1999, *Bird in a Cage: Legal Reform in China after Mao*, Stanford: Stanford University Press, p. 276.

75. Andrew Jeffries, and James Kwan, International Arbitration Group, Allen & Overy, Hong Kong, July 27, 2004.

76. Donald C. Clarke, 2003, "Empirical Research in Chinese Law," in Erik Jensen and Thomas Heller (eds.), *Beyond Common Knowledge: Empirical Approaches to the Rule of Law*, Stanford, Calif.: Stanford University Press, p. 171.

77. Note that arbitration for foreign firms has typically taken place within a distinct set of institutions, including international arbitration enforceable under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards adopted in New York on June 10, 1958 and arbitration enforeceable under the China International Economic and Trade Arbitration Commissions' rules. Randall Peerenboom, 2001, "Seek Truth From Facts: An Empirical Study of Enforcement of Arbitral Awards in the PRC," *American Journal of Comparative Law*, Vol. 49, p. 251.

78. Interview with lawyer nj020925p.

79. Stanley Lubman, 1999, *Bird in a Cage: Legal Reform in China after Mao*, Stanford, Calif.: Stanford University Press, pp. 242–244. As Stanley Lubman notes, other state agencies handled special types of arbitration, for example, Science and Technology Commissions established special arbitration commissions to handle disputes within their bailiwick.

80. Arbitration Law of the People's Republic of China (*zhonghuarenmingongheguo zhongcaifa*), 2001, Beijing: zhongguo fazhi chubanshe.

81. Bing He, 2002, "Reconstructing the Mechanism of Dispute Resolution," *Peking University Law Journal*, Vol. 14, No. 1, p. 28.

82. *State enterprises* here refers to state-run firms or shareholding enterprises in which the state is the majority shareholder. *Large* is indicated by employment levels above the median in the sample.

83. In reviewing the history of arbitration, staff members at the Shanghai Arbitration Commission highlighted the larger role for the earlier state-administered arbitration commission in the 1980s, when state enterprises dominated the economy (interview with Shanghai Arbitration Commission sh040817a).

84. *Quanguo renming fayuan sifa tongji lishi ziliao huibian 1949–1998 (Mingshi bufen)*, 2000, Beijing: renming fayuan chubanshe; Zhongguo falu nianjian, various years.

85. Bing He, 2002, "Reconstructing the Mechanism of Dispute Resolution," *Peking University Law Journal*, Vol. 14, No. 1, p. 28.

86. Litigation of contract disputes in the United States typically involves uncommon circumstances, including failed businesses, abandoned product lines, very high stakes, or extreme miscalculations (Daniel Keating, 1997, "Measuring Sales Law against Sales Practice: A Reality Check," *Journal of Law and Commerce*, Vol. 17, No. 1, pp. 99–130).

87. Zhou Xueguang et al., 2003, "Embeddedness and Contractual Relationships in China's Transitional Economy," *American Sociological Review*, Vol. 68, No. 1, p. 91.

88. Qiu Ju is the protagonist in Zhang Yimou's 1992 film adaptation ("The Story of Qiu Ju") of Chen Yuanbin's novella "The Wan Family's Lawsuit."

89. This is consistent with the findings in Ethan Michelson, 2006, "The Practice of Law as an Obstacle to Justice: Chinese Lawyers at Work," *Law & Society Review*, Vol. 40, No. 1, pp. 1–38.

90. Stanley Lubman, 1999, *Bird in a Cage: Legal Reform in China after Mao*, Stanford, Calif.: Stanford University Press.

91. New China News Agency (xinhuashe), 2000, "*quanguo lushi zigekaoshi gongbufenshuxian*," December 8, 2000, accessed at www.people.com.cn/GB/channel1/12/20001208/342830.html.

92. "*woguojicengfaguan renshujiejinshiwuwanrenfayuan cuenzaisidawenti* (The Number of Basic-Level Judges in Our Courts nears 150,000; Four Major Problems Exist in the Courts)" October 26, 2004, www.xinhuanet.com/newscenter/2004-10/26/content_2141302.htm.

93. "*zhongguojiangjingjian faguanrenshu, tueixingfaguanzhiyehua* (China Reduces the Number of Judges, Implements Professionalization of Judges)," July 7, 2002. www.news.xinhuanet.com/zhengfu/2002-07/08/content_472993.htm.

94. Note that both court-sponsored mediation and court decisions are enforceable decisions.

95. Kathryn Hendley, Peter Murrell, and Randi Ryterman, 2000, "Law, Relationships, and Private Enforcement: Transactional Strategies of Russian Enterprises," *Europe-Asia Studies*, Vol. 52, No. 4, pp. 627–656.

96. Pitman B. Potter, 1992, *The Economic Contract Law of China*, Seattle: University of Washington Press, p. 99.

97. Here it is important to distinguish interference due to the institutional interests of the state from interference due to the personal interests of powerful state officials (i.e., outright corruption).

98. This experience is in contrast with the experiences of parties to other kinds of disputes. With respect to administrative litigation, for example, see Veron Hung, 2004, "China's WTO Commitment on Independent Judicial Review: Impact on Legal and Political Reform," *The American Journal of Comparative Law*, Vol. 52, No. 1, pp. 77–132.

99. www.court.gov.cn as cited in *China Law and Governance Review* (June 2004) www.chinareview.info. See also Donald C. Clarke, 1996, "Power and Politics in the Chinese Court System: The Enforcement of Civil Judgments," *Columbia Journal of Asian Law*, Vol. 10, No. 1, pp. 1–125.

100. Donald C. Clarke, 1996, "Power and Politics in the Chinese Court System: The Enforcement of Civil Judgments," *Columbia Journal of Asian Law*, Vol. 10, No. 1, pp. 1–125.

101. Donald C. Clarke, 1996, "Power and Politics in the Chinese Court System: The Enforcement of Civil Judgments," *Columbia Journal of Asian Law*, Vol. 10, No. 1, p. 28.

102. The court records suggest that the minimum fee for court-sponsored implementation was 150 rmb, but for larger awards, more typically approximately 1.25–1.5 percent of the award amount (a fee incurred by the winning side).

103. Donald C. Clarke, 1996, "Power and Politics in the Chinese Court System: The Enforcement of Civil Judgments," *Columbia Journal of Asian Law*, Vol. 10, No. 1, pp. 1–125; Stanley Lubman, 1999, *Bird in a Cage: Legal Reform in China after Mao*, Stanford, Calif.: Stanford University Press, p. 268.

104. In interviews, lawyers, judges, and managers alike commented on the publication of unenforced judgments in the Xinmin Evening News (Xinmin wanbao). See

also the national publicity this practice received in the People's Daily: "Shanghai guaqi'zhixing baofeng'" *Renmin ribao*, 2001.09.21, accessed at www.people.com.cn/GB/paper40/4279/492229.html.

105. Donald C. Clarke, 1996, "Power and Politics in the Chinese Court System: The Enforcement of Civil Judgments," *Columbia Journal of Asian Law,* Vol. 10, No. 1, p. 34.

106. Martin Shapiro, 1981, *Courts: A Comparative and Political Analysis*, Chicago: University of Chicago Press, p. 13.

107. Jonathan R. Hay, and Andrei Schleifer, 1998, "Private Enforcement of Public Laws: A Theory of Legal Reform," *American Economic Review,* Vol. 88, No. 2, pp. 398–403.

108. The manager further described the gang as composed of members of the local public security bureau.

109. Of course, the small role reported for such practices may reflect an unsurprising reticence about discussing these methods.

110. The perception of authority combined with unfairness may stem from the excessive formalism of judgments in many Chinese courts (Potter 2002).

111. Martin Shapiro, 1981, *Courts: A Comparative and Political Analysis*, Chicago: University of Chicago Press; Kathryn Hendley, Peter Murrell, and Randi Ryterman, 2000, "Law, Relationships, and Private Enforcement: Transactional Strategies of Russian Enterprises," *Europe-Asia Studies,* Vol. 52, No. 4, p.6 32.

112. See note 4, above.

113. Related debates occur, for example, with respect to the relationship between political culture and democracy/democratization (Edward N. Muller, and Mitchell A. Seligson, 1994, "Civic Culture and Democracy: The Question of Causal Relationships," *American Political Science Review,* Vol. 88, No. 3, pp. 635–652; Sidney Tarrow, 1996, "Making Social Science Work Across Space and Time: A Critical Reflection on Robert Putnam's *Making Democracy* Work," *American Political Science Review,* Vol. 90, No. 2, pp. 389–397).

114. Hugh T. Scogin Jr., 1994, "Civil 'Law' in traditional China: History and theory," in Kathryn Bernhardt and Philip C. C. Huang (eds.), *Civil law in Qing and Republican China*, Stanford, Calif.: Stanford University Press, p. 15.

115. For the debate with respect to Japan, see John Haley, 1978, "The Myth of the Reluctant Litigant," *Journal of Japanese Studies,* Vol. 4, No. 2, pp. 359–390; on Taiwan, see Jane Kaufman Winn, 1994, "Relational Practices and the Marginalization of Law: Informal Financial Practices of Small Businesses in Taiwan," *Law and Society Review,* Vol. 28, No. 2, pp. 193–232; on Korea, see Tae-kyu Park, 1997, "Confucian Values and Contemporary Economic Development in Korea," in Timothy Brook and Hy V. Luong (eds.), *Culture and Economy: The Shaping of Capitalism in Eastern Asia*, Ann Arbor, MI: University of Michigan Press, pp. 125–136.

116. Randall Peerenboom, 2001, "Seek Truth from Facts: An Empirical Study of Enforcement of Arbitral Awards in the PRC," *American Journal of Comparative Law*, Vol. 49, pp. 249–327.

117. John Haley, 1978, "The Myth of the Reluctant Litigant," *Journal of Japanese Studies,* Vol. 4, No. 2, pp. 359–390; Jane Kaufman Winn, 1994, "Relational Practices and the Marginalization of Law: Informal Financial Practices of Small Businesses in Taiwan," *Law and Society Review,* Vol. 28, No. 2, pp. 193–232.

118. Shin-yi Peng, 2000, "The WTO Legalistic Approach and East Asia: From the Legal Culture Perspective," *Asian-Pacific Law and Policy Journal,* Vol. 13, p. 32.

119 John Haley, 1978, "The Myth of the Reluctant Litigant," *Journal of Japanese Studies,* Vol. 4, No. 2, p. 381.

120. John Haley, 1978, "The Myth of the Reluctant Litigant," *Journal of Japanese Studies,* Vol. 4, No. 2, p. 389. This situation began to change in Japan, Korea, and Taiwan during the 1990s.

121. Korean data from the Korean Bar Association (accessed at www.koreanbar.or.kr/eng/03.asp) and the World Bank (accessed at www.worldbank.org).

122. Ibid. and "Database Keeps Tabs on Lawyers," China Economic Net, August 5, 2004 (en.ce.cn/National/Law/200408/05/t20040805_1419061.shmtl).

123. Rosemary Foot, 2000, *Rights Beyond Borders: The Global Community and the Struggle over Human Rights in China*, Oxford: Oxford University Press, p. 258.