LAW AND ECONOMIC GROWTH: THE CASE OF TRADITIONAL CHINA

- A REVIEW WITH SOME PRELIMINARY HYPOTHESES

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Abstract: This paper inserts the Chinese legal regime into the law and growth literature and brings the question of law and legal institutions to bear on Chinese economic history. It offers a review of recent literature to elucidate the nature of traditional Chinese legal system and the mechanism of dispute resolution embedded in an disciplinary mode of administrative law within a bureaucratic hierarchy and intermediation within social-networks. As such a legal regime dictates the definition, interpretation and enforcement of contract and property rights in traditional China, it casts doubts on the revisionist case for a secure and flexible property rights regime in China. It proposes some preliminary hypotheses on economic efficiency implication of traditional Chinese legal system highly relevant to understanding China's long-term growth trajectory.

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Abstract: This paper inserts the Chinese legal regime into the law and growth literature and brings the question of law and legal institutions to bear on Chinese economic history. It offers a review of recent literature to elucidate the nature of traditional Chinese legal system and the mechanism of dispute resolution embedded in an disciplinary mode of administrative law within a bureaucratic hierarchy and intermediation within social-networks. As such a legal regime dictates the definition, interpretation and enforcement of contract and property rights in traditional China, it casts doubts on the revisionist case for a secure and flexible property rights regime in China. It proposes some preliminary hypotheses on economic efficiency implication of traditional Chinese legal system highly relevant to understanding China's long-term growth trajectory.

Western law – its unique features of legal formalism and rule of law – as argued by Max Weber has laid the foundation of Western capitalism (Trubeck 1972). The role of law to economic growth has made a recent comeback in the large and growing literature on law and finance (La Porta et al) and legal origins (Glaeser and Schleifer, 2002). Yet, in this new law and growth literature, the old Weberian interest in legal traditions around the world was forsaken for a much narrower focus of Western European legal regimes only, namely, Common versus Civil laws. The so-called cross-country growth regressions – cross-country intended to cover most if not all the countries – simplifies the legal regimes around the global today to dummy variables of common versus civil law. Irrespective of the finer subdivisions of Civil Law regimes: Scandinavian, Germanic, French and Spanish legal traditions, this literature no longer seems to bother with the Hindu, Islamic or Confucius and other non-Western legal traditions that had been the focus of intellectual attention of scholars like Weber who, at his time, possessed neither the means to trot the globe or the tools to run two or four million regressions.[1]

Can this narrowing of intellectual vision be justified by the convergence of global legal

[1] Similarly, law in the so-called standard literature of law and economics championed by the Chicago school (Coase, Posner and Becker) is simply understood to be that of the European legal traditions, see Parisi and Rowley 2005.

traditions with the spread of the European colonialism? Not quite so: the Western victory in the "legal" battle is far from over. Non-Western legal traditions continued to form the mainstream of the legal systems in a large part of the developing world today - the operation of Islamic law in many Middle-Eastern countries is a case in point. Even for those that officially adopted Western legal regime and lexicon, indigenous legal traditions are still predominant in the developing world. By classifying the whole world into two European legal regimes, we commit the fallacy of model mis-specification our model and attributing either too much credit or too much blame for the economic success and failures of the developing world in the non-West.

Alongside this new literature on formal law is another scholarship on the so-called "order beyond or without law," often couched in game-theoretic terms, brings us important theoretical insights on how repeated interaction of economic agents in a long-term horizon lead to the rise of self-enforcing rules and institutions (Greif, 2005). An important corollary of this argument coming out of Avner Greif's insightful case study that while Western Europe, as symbolized by the Italian city-states of the Medieveal era evolved towards the rise of formal rule and state, while the Muslim societies, as revealed by the Magrebi traders, remained stuck with an informal group-based multilateral sanction mechanism for contract enforcement. This corollary raises to us the question of dynamic efficiency of different institutional mechanism – formal versus informal, legal versus extra-legal – to long term economic growth.

In this context, recent revisionist scholarship on traditional Chinese legal traditions is of particular interest. This new scholarships reveals surprising findings that overturns the old Weberian interpretation of the Chinese legal system and conjures up a portrait of pre-modern China where property rights were reasonably secure, the freedom to contract was pervasive, and public enforcement of contracts was by and large rule-based. This line of scholarship lends some interesting insights to the argument by the California school on Chinese economic history. The California school has taken to

task the long-term stagnation thesis and contend for a case of substantial progress in industrial and agricultural technologies, expansion of regional trade, growth in urbanization, and perhaps even demographic transition for early modern China. In his influential book, "Great Divergence," Kenneth Pomeranz views the property rights or the freedom to contract in traditional China as no less secure or flexible than in Western Europe.[2]

The rise of the post-WWII East Asian miracle and China's remarkable economic growth from the late-1970s provides an important motivation for the revisionist impulse. It is often argued that the crucial institutional factors that accounted for the two decades of economic miracles in China - ranging from the household responsibility system, the township and village enterprise, to the overseas Chinese networks of FDI to China - are largely informal, spontaneous and often ad-hoc.

This paper inserts the Chinese legal regime into the law and growth literature and brings the question of law and legal institutions to bear on Chinese economic history. It offers a review of recent literature to elucidate the nature of traditional Chinese legal system and the mechanism of dispute resolution embedded in an disciplinary mode of administrative law within a bureaucratic hierarchy and intermediation within social-networks. As such a legal regime dictates the definition, interpretation and enforcement of contract and property rights in traditional China, it casts doubts on the revisionist case for a secure and flexible property rights regime in China. It proposes some preliminary hypotheses on economic efficiency implication of traditional Chinese legal system, which is highly relevant to understanding China's long-term growth trajectory.

The rest of the article is divided into three sections. The first section reviews the traditional Chinese legal system in a comparative perspective. The second section examines the question of Chinese civil law. The third section puts forward some preliminary hypotheses on the economic impact

[2] For a summary of the California school, see Ma 2004b. See Pomeranz (2000) on the flexibility of traditional Chinese factor markets. See Philip Huang, Zelin et al for these revisionist studies on traditional Chinese legal system.

of traditional Chinese legal system.

I. Law and Legal System in Traditional China

The modern Western legal tradition, according to Harold Berman, originated in the Papal Revolution of the Middle Ages and evolved in a Medieval political context of separation between church and state and political fragmentation. These features of Western law as summarized by Berman are:

- There is a sharp distinction between legal institutions and other types of institutions. Custom, in the sense of habitual patterns of behavior, is distinguished from customary law, in the sense of customary norms of behavior that are legally binding;
- The administration of legal institution is entrusted to a special corps of people, who engage in legal activities on a professional basis;
- The legal professionals are trained in a discrete body of higher learning identified as legal learning, with its own professional literature and in its own professional schools.
- There is a separate legal science, or a meta-law. Law includes not only legal institutions, legal commands, legal decisions and the like but also what legal scholars say about them;
- Law has a capacity to grow and the growth of law has an internal logic;
- The historicity of law is linked with the concept of its supremacy over the political authorities. The rulers (or the law-makers) are bound by it;
- Legal pluralism – the co-existence and competition within the same community of diverse jurisdictions and diverse legal systems – is most distinctive characteristics of the Western legal tradition (Harold Berman, p. 7-8).

These features are in line with Max Weber's distinction between formal and substantive justice. Under formal justice, legal adjudication and process for all individual legal disputes are bound by a set of generalised and well-specified rules and procedures. Substantive justice, on the other hand, seeks

the optimal realisation of maximal justice and equity in each individual case, often with due consideration to comprehensive factors, whether legal, moral, political or otherwise. Formal justice tends to produce legal outcomes that are predictable and calculable, even though such outcomes may often clash with the substantive postulates of religious, ethical or political expediency in any individual case. Formal justice, as argued by Weber, reduces the dependency of the individual upon the grace and power of the authorities, thus rendering it often repugnant to authoritarian powers and demagoguery.

Weber believed that formal justice is unique to the European legal system. The European legal organization was highly differentiated, separate from the political authority and characterized by the existence of specialized and autonomous professional legal class. Legal rules were consciously fashioned and rulemaking was relatively free of direct interference from religious influences and other sources of traditional values. Above all, the rule of law born out of the Western legal tradition supplied what Weber termed as calculability and predictability, elements essential for explaining the rise of Western capitalism and its absence in other civilizations.[3]

The Weberian synthesis permeated the thinkings of generation of sinologists on the Chinese legal tradition. John King Fairbank remarked that "the concept of law is one of the glories of Western civilization, but in Chinese, attitude toward all laws has been a despised term for more than two thousand years. This is because the legalist concept of law fell far short of the Roman. Whereas Western law has been conceived of as a human embodiment of some higher order of God or nature, the law of the legalists (in China) represented only the ruler's fiat. China developed little or no civil law to protect the citizen; law remained largely administrative and penal, something the people attempted to avoid as much as possible" (1960, p.84).

In another study, Thomas Stephens defined the Chinese legal tradition as "disciplinary" versus

[3] Weber (1978), vol.II, p.812. Unger (1976) and Trubek (1972), p.721.

"adjudicative" or "legal" in the West. In a "disciplinary" legal regime, rules prescribing conduct are peripheral in a hierarchical society where group interest takes priority over individual rights. Stephens further contents that in contrast to the existence of jurisprudence as a systematic exposition of the "adjudicative" and "legal" regime, the "disciplinary" regime finds no such systematic theorization (p.6). A comprehensive reformulation of this bipolar contrast between Western and Chinese legal traditions can be found in a recent book by Chinese legal scholar, Zhang Zhongqiu, who summarized them into eight categories. The Chinese legal tradition, according to him, originated in tribal wars, was collectivist, dominated by public law, oriented towards ethical value, singular and closed, encapsulated in official legal codes, founded on the rule by man, and aimed for the ideal of no litigation, whereas Western law originated in clan conflicts, was individualistic, dominated by private law, oriented towards religious value, plural and open, expounded by jurisprudence, founded on the rule of law and aimed for justice (2006).

These broad-brush characterizations, while useful in certain ways, are clearly simplistic and carry strong value-judgement. Below, I turn to the more detailed and nuanced research guided both by the reading of the archived legal cases and modern theory of jurisprudence.

It is beyond doubt that the emperor is the source of Chinese law and Chinese legal apparatus was an integral part of the administrative system with bureaucracy within the hierarchy – from the county level to the emperor – acting as the arbiter in criminal cases. But there is a system of checks to ensure consistency. The Chinese penal code was highly sophisticated, reasonably rigorous and systematic. The compilation of China's first legal code dated to 629 in the Tang dynasty (revised and completed in 737), only a hundred years after the Justinian code (drafted in 529 and promulgated in 533). Shiga Shuzuo pointed out that almost all the court rulings on criminal cases were required to cite specific official penal codes and statures as support. Furthermore, legal decisions on criminal cases, depending on the severity of punishments, would need to be reviewed through the administrative

hierarchy with capital punishment reviewed and approved by the emperor himself (Shiga et al p.9). In fact, officials at the lower level would face punishment if their rulings were reviewed to be mistaken.

Despite the rigor and sophistication of this legal system, Shiga stopped short of calling it "adjudicative" in the Western legal tradition. It is after all a bureaucratic law designed for the officials to meter out punishments proportionate to the extent of criminal violations. The official legal codes were structurally organized along the six ministerial divisions under the imperial bureaucracy: government, revenue, ceremony, justice, military and works (Liang, 1996, p.128-9). "More than half of the provisions of the Qing code, as pointed out by William Jones, are devoted to the regulation 'the official activities of government officials'" (cited in Ocko and Gilmartin). The meticulous and sophisticated juridical review process is carried out top-down within the administrative hierarchy.

In the case that the emperor made decisions and rulings outside the purview of extant legal statutes or contravened existing codes, these decisions became new laws or sub-statutes to be used as legal basis for future cases (Shiga et al, pp.11-12). In fact, as emphasized by Shiga and Terada, as the formal legal codes changed little over the dynasties, the emperor's legal decisions on individual cases formed the single most important dynamic changes to China's formal legal system (Shiga et al pp. 120-121). Although facing no formal legal constraints, the emperor recognizes the power of informal constraints such as the much talked about "mandate of heaven". While the effectiveness of such constraints is highly questionable, the emperors recognize the value of consistency, fairness and balance in the legal system (Ocko and Gilmartin, p. 9).

Legal statutes or sub-statutes were not open to contestation and interpretation by the litigating parties or independent third parties. In this regard, it is easy to understand that the Chinese version of "jurisprudence" (Lu-Xue) almost exclusively focused on largely technical issues on the application, interpretation and exposition of legal punishment. In fact, Shiga pointed out the etymology of the word

"Lu" refer to musical notes. So in essence, traditional Chinese legal studies are all about finding the appropriate scale of punishments for crimes (p.16). This leads Zhang Zhongqiu to reject the use of the word "jurisprudence" to translate Chinese legal study (chapter 6).

In sum, the Chinese legal system, at its best, approximates a system of rule by law but not rule of law, a system of checks but without balances of power. To rule an empire as large as China, consistency and predictability could benefit the long-term stability when disciplinary power had to be delegated to a vast bureaucracy. So a "disciplinary" mode of justice does not necessarily lead to complete arbitrariness.

II. Chinese Civil Law?

The etymology of the Chinese word for law, "fa," as pointed out by Su Yegon, denotes specifically to "punishment." Understanding this etymology takes us to the long-held view there was simply a complete absence of official civil law or commercial law (Su, p.6). Chinese legal codes were fundamentally penal, not amenable to dispute resolution of a commercial and civil nature. However, this long-held view is also being seriously challenged. New research reveals that the county magistrates, the lowest level bureaucrats, handled and ruled on a vast amount of legal disputes that did not entail any corporal punishment. These include civil and commercial cases.[4]

But Shiga's careful research points out that these county-level trials were something more akin to a process of 'didactic conciliation', a term he borrowed from the studies by Western scholars on the Tokugawa legal system in Japan. The decisions of the magistrates were not legal 'adjudications' as in the Western legal order. The magistrate's ruling was effective and a legal case was considered as resolved or terminated only to the point that both litigants consented to the settlement and made no further attempts for appeals. Although not common, Shiga did point to cases where a legal dispute dragged on indefinitely when one of the litigating parties reneged on – sometime repeatedly - and thus

[4] For the extent of average people utilising the county level civil trial system, see Susumu Fuma's article in Shiga *et al.* and also Huang (1996).

refused to fulfil his or her original agreement to the settlement. Thus, ruling lacked the kind of binding and terminal force as the legal adjudication in the modern sense

Shiga was also interested in the legal basis of magistrate's rulings and found that although invoking general ethical, social or legal norms, they rarely relied on or cited any specific codes, customs or precedents. In accordance with its intermediation characteristics, the magistrate's ruling showed less concern for the adoption of a reasonably uniform and consistent standard than the resolution of each individual case with full consideration to its own merits.[5] Shiga made a general case that the magistrates often resorted to a combination of "emotions, reason and law" (Qin, Li, Fa) as tools of persuasion.

This can best be illustrated by a specific case used by Shiga:

A widow of over 70-year old, Mrs. Gao, living in 19th century Shandong province pawned land to her junior uncle and his two sons at 45,000 cash. Later, Mrs. Gao wanted her cousins to buy and take over the land by paying an additional 50,000 cash. The cousins refused and the disputes were taken to the court.

The magistrate started his ruling by declaring that the blood relations are far more important than money matters and the welfare of the old widow needs to be looked after by her extended family. As there is a local custom that usually sets the pawning price of land at half of the sale value of the land, the widow should ask for an additional 45,000 cash rather than 50,000 from the cousins. The magistrate further advised that the uncle and his two sons could share in their payment to the widow. The dispute seemed to be resolved with both parties agreeing to the magistrate's settlement (Shiga et al, p. 56).

The specific case shows clearly that the magistrate's ruling goes far beyond narrow legal spheres. In fact, he was much more interested in influencing the outcome – rather than the rules - of the game by

[5] For Shiga's analysis, see Shiga *et al*(1998), Shiga (2002, 1996).

bringing about what he viewed a socially ethical and harmonious outcome at the expense of the original terms of the agreement. His ruling relied on the power of persuasion more than a legal basis.[6] Shiga's particular interest in this case comes from the fact this is one of the few that specifically cited a local custom. But clearly, as Shiga points out, the customs cited here was nowhere implicated as the legal basis of his ruling or a binding social rule. In fact, Shiga pointed out other cases where local customs were simply ignored or even condemned (Shiga et all, pp. 57-59).

Following Shiga, Jerome Bourgon pointed out that the direct transliteration of modern Western legal terms on traditional Chinese terms could sometime lead to misconception of the fundamental gap between the two legal traditions. Bourgon pointed out that there is no equivalent legal term in Chinese that corresponds exactly to the Western terminology for "customs." The direct transliteration of "custom" for the Chinese word "xiguan" could be misleading. "Customs" in the West was not merely a sociological phenomenon but also a judicial artifact, asserted by witnesses, or appreciated by the jury, often with a clear territorial delimitation. The modern civil law in many ways formed through the amalgamation and standardization of traditional customary laws in different territories of jurisdiction. In contrast, "customs" in China, according to Shiga and Bourgon, identifies only loose, mostly unwritten social practices without territorial delineation. They might at times serve as a reference but almost never formed the specific legal basis upon which the county magistrates made their decisions or the litigants made their claims. So they do not "harden" into law.

This Weberian interpretation of traditional Chinese legal system was vigorously contested by the recent legal revisionist scholar, Philip Huang. Based on his reading of Qing archival legal cases of civil disputes, Huang challenged Shiga's thesis and demonstrated that the rulings of magistrates were far

[6] Similar points are also made by Liang Ziping who argued that the magistrate would not hesitate to issue rulings that could result in the alteration or simplification of the original agreements between the litigant parties if this would help "quiet both parties" There also tendencies of the state or local magistrate to lean towards simplistic and flexible means rather than attempt to establish consistent and generalizable rules or precedents when it comes to the resolution of highly complex commercial disputes, see Liang, pp.134-140. Also see Mio Kishimoto.

from being arbitrary but rather, rooted in formal legal codes and seemed legally binding in most of the cases. Huang's sharply contrasting interpretation of the traditional Chinese legal system based on similar legal archives studied by Shiga and others is surprising. The source of discrepancy, as pointed out in a series of rebuttals by Shiga and Terada, is the methodology that Huang adopted to arrive at his conclusion. Although there was no evidence to show that the original rulings by the magistrates cited any legal statues or local customs as their legal basis, Huang matched the contents of the ruling with the what he deemed as the relevant codes in the formal Qing legal penal code (Shiga 1996 and Terada 1995).

Clearly, there is much to be desired about Huang's methodology of inserting codes ex post to back up legal rulings made by magistrates several centuries earlier. However, the idea that magistrates ruled by some general moral and legal concepts and principles embedded in formal legal codes does merit attention. In fact, Huang's criticism of Shiga thus framed actually takes him close to the original position of Shiga who explicitly stated that magistrate's ruling appealed to a wide set of moral and ethical values most of which could be embedded in formal legal codes. But there is a key difference between a legal system that transforms generalized principles into legal codes or precedents subject to interpretation and contestation by independent third parties and one that entrusts the interpretation of these principles to the hearts and minds of individual magistrates. This is after all the distinguishing mark between the rule of law and rule of man, a point that is lost in Huang's reinterpretation.

The nature of the Chinese legal system in civil and commercial matters so described raises a set of questions. In the absence of a formal contract law, why do we observe the proliferation of written "contracts" or agreements throughout Chinese history? If magistrates' rulings were not adjudications in the Western legal sense, lacking in both finality and enforceability backed by the state coercive

power, why did people bother to take their disputes to the county court?[7]

To the first question, the most straightforward answer comes from the contributing authors of a recently edited volume on traditional Chinese legal system (Zelin, Ocko and Gardella): "…regardless of subject matter, contracts and "documents of understanding" were more social than legal in nature because they were rooted in and protected by the social relationship of the parties;" or alternatively put, "the surest guarantee of one's rights seems to have been their acknowledgement by the local community" (by Myron Cohn and Ann Osborne respectively, cited in Ocko and Gilmartin, p. 28). As emphasized by Terada, disputes over properties and contracts were often resolved or regulated through the interplay of social norms, power, compromise and rational recognition of long-term benefit and cost (Shiga et al, pp.191-279). The importance of social relation behind contracts partly explains the motivation for litigation at the Magistrates' court. People filed complaints to enforce a contract and settle a debt and so on, but getting a case accepted for hearing also made use of courts to intimidate, coerce, and to turn the balance of social power in favour of the litigants within the social networks. Parties to private agreements utilized formal litigation as a means to gain advantages in a power relationship over private agreements, a process more aptly termed as "litinegotiation" (Ocko and Gilmartin, p. 24).

One such case in point is recorded by a recent study of the resolution of commercial disputes in the highly commercialized Huzhou region of Anhui province in Ming and Qing. According to Han Xouyao, a serious and protracted land dispute between two large lineages in the area broke out and lasted across generation for a total of 111 years (from 1423 to 1551), and saw numerous trials and rulings by the county and prefecture courts and incidences of violent conflicts. In spite of the official ruling from the prefecture court, the disputes only ended with the drafting of a "truce" agreement signed by the two lineages and witnessed by middle men and village elder (pp. 93-117).

[7] Bear in mind these trials were very costly and heavily discouraged by the officials. See Deng Jianpeng, chapter 2.

This mode of dispute resolution is consistent with the observation that the Chinese state legal system often entrusted or "farmed out" coercive violence or disciplinary duties to non-official elites. Shiga, for example, documented in detail that lineage leaders were sanctioned the power to punish their own members sometimes up to capital punishment subject to official review (Shiga 2002, chapter 2). Similarly, village elders or elites, guild leaders also possessed similar powers of corporeal punishment over their members (Han 2004, chapter 2). In turn, the State would hold the leader(s) of a group or community accountable for crimes or misdemeanours committed by its junior members. Thus embedded in the formal legal system is a system of collective responsibility and a vague distinction between legal and extra-legal. This is consistent with the historical observation of the prevalence of informal and internal rules in the form of family bylaws, lineage rules and guild regulations, in particular the prominence of region and lineage-based Chinese merchant groups (Ma 2004b).

Chinese law, as pointed out in Ch'u T'ung-tsu's classic study, is fundamentally hierarchical with the senior members in a society (whether defined by bureaucratic status, age or gender) entitled to lesser punishment to the same crime than the junior ones. This hierarchical structure of punishment is a reflection of the neo-Confucian ideal where the elder members of the society, through the inculcation of Confucian values and character-building, were presumably better endowed with social, ethical and legal values to guide and discipline the lower echelon of the society. This leads to the a decentralization of coercive power on civil and commercial disputes into the members of the society that internalized the Confucian values away from the monopoly by an impersonal and independent legal institution. This of course turns us back to the distinction between rule of man and rule of law.

III. Law and Economic Growth in Traditional China: Some Preliminary Hypotheses

The question of central interest to us is the economic effects of this legal system, both in the static and dynamic sense. It is relatively easy to advance – but much harder to empirically verify-

some hypotheses on the transaction costs such a system of rule of law could impose on contract and property.

Firstly, a legal regime characterized by the predominance of social and power hierarchy could render the definition and enforcement of contract and property rights dependent upon a power structure. This is testified by the massive investment of Chinese merchant lineage in their offspring' preparation for China's Civil Service Examination based on Confucius classics. Passing and rising through the ranks of this examination hierarchy would guarantee bureaucratic posts in the government that in turn provide shelter for the lineage wealth (Ma 2004b). Ch'u T'ung-Tsu's study on Qing local government also reports the widespread practise of buying official titles by wealthy families (cited in Deng, p.68-69). In fact, Deng Jianpeng presented a case of a fundamental dilemma of property rights in China. In Western Europe, through a form of representative institution (dating back to the Greek period), property ownership leads to political power. In China, this same route went the opposite direction: from political power flows the property. Hence the dilemma: the absence of formal legal protection sends property owners to seek custody under political power, yet property supported by political interest lacks legality.[8]

Secondly, extra-legal or informal type of enforcement within the social networks mechanism has its advantages and costs. One problem is the pervasive certainty associated with contracts especially within a social network, which can be illustrated by Mio Kishimoto's careful case study of land sales (2003). In many regions, there are customs that entitled sellers of land to compensation from their buyers especially after land prices went up after the initial sales. This leads to widespread abuse with the sellers requesting compensation far beyond the customary rule or the original terms of the agreement. Resorting to reasons of sickness, old age, hunger, bad harvest, and sometimes just extortion, some sellers turn this compensation request into annual affair (especially around the

[8] See Deng, p.69. Also see Chang Chung-li for the enormous wealth accumulated by Chinese gentry bureaucrats.

Chinese New Year).

More importantly, there is an effect of diminishing returns to scale in a private or relation-based mechanism noted by sociologists and legal scholars on China. Liang Ziping quoted an analogy by the eminent Chinese sociologist Fei Xiaotong who likens the reach and influence of the Chinese social order to circles of ripples stirred up by a stone thrown into the water: the farther away from the center, the weaker their strength becomes (Liang, pp.157-8). Liang's own extensive study of various private contracts and customs leads him to emphatically conclude that Chinese local rules and customs were only binding and effective within their existing social networks (p. 165-6).

As pointed out by Greif and others, in a relation and group-based mechanism, the extent of exchange and the scale of operations may be subject to sharply rising costs of information and coordination as the group and extent of trade expands. In contrast, an enforceable legal system with a set of codified and transparent standards and rules, subject to the interpretation and contestation of independent third parties may be more costly to set up initially but could exhibit strong scale economies to sustain larger volumes of trade, thus conducive to the rise of large-scale impersonal exchange beyond the internal groups (Greif, 2002, 2004, John Li). This is of course the Weberian notion of predicability and calculability of formal rationality which laid the foundation of modern capitalism based on impersonal exchange.

A third – perhaps both more consequential and subtle – point about the problem of a person-based legal system in comparison with a rule-based system is the long-term growth potential. Moral and ethical principles internalized in the hearts and minds of individual bureaucrats as in the case of traditional Chinese "civil trials" did not enter into a sphere of public knowledge subject to debate, reflection, analysis or synthesis which generates the possibility for new knowledge. This is of course the most important dynamic element underlying the so-called historicity of Western law as defined by Harold Berman earlier: Western law has a capacity to grow and this growth has an internal logic. This

particular point calls up our earlier discussion on the absence of jurisprudence (in Western sense) in traditional China.

The discussion on the importance of public knowledge and social learning can best be illustrated by invoking Joel Mokyr's recent resurrection of the role of the scientific revolution and industrial enlightenment to the industrial revolution in England. The significance of the industrial revolution lies in its cumulative and sustainable effect on growth which is distinguished from earlier growth spurts that usually peter out after a period. What changed in 18th century Europe is what he termed an expanded epistemic base resultant from the foundation of scientific revolution and industrial enlightenment. Key to this argument is that knowledge has the characteristics of a public good and acts as a fixed input that could generate scale economies. Furthermore, through a feedback loop between what he termed prescriptive and propositional knowledge, knowledge itself generates a learning process that creates new knowledge (Mokyr 2002).

Undoubtedly, there is the large question of how relevant a theory of knowledge in natural science could be to the study of the evolution of legal institutions and its impact on economic change. However, I argue that the analogy can be shown to be far more relevant than is thought perhaps in a larger research agenda. Here I put forward some casual comparison.

It is important to recognize that formal law especially in commercial affairs evolved slowly in the West as well partly because commercial disputes tended to be highly specialized and formal legal litigation and enforcement could be extremely costly. Merchants in Medieval and early modern Europe relied extensively on private solutions such as mediation and arbitration to resolve commercial disputes (Oscar Gelderblom 2005). But over time, commercial customs and practices became increasingly codified and unified especially in major trading centers, often under the jurisdiction of relatively autonomous local government or independent city-states (Greif 2005). Major intellectual and political revolutions such as the Reformation and the Enlightenment movement, particularly the

rise of modern nation-states became a major force that propelled the formation of modern Civil Law (Berman 1983, Bourgon).

A similar linkage - or to borrow Mokyr's term - a feedback loop can be detected between the ideal of John Locke, the French enlightenment thinkers and James Maddison and the political events of Glorious Revolution, American Independence and French revolution. In this feedback process evolved new theories of jurisprudence on public laws and constitution that helped institutionalize a strong form of the rule of law in the US (Adam Tomkins).

In China, we see the embryonic and informal form of most of the modern financial and commercial instruments such as paper money, bills of exchange, bills of lading, joint-stock shares or insurance contracts as well as forward or futures markets. As David Faure and others forcibly argued, the Chinese lineages particularly in China's highly commercialized regions are "fictional" merchant organizations with strong "corporate" characteristics. But few of these institutional innovations in commercial instruments and organizations were translated or "hardened" to formal laws. Similarly, state renege on contracts and appropriation of private properties were a recurrent theme throughout Chinese history. But these do not lead to the development of a political theory that formalize institutional constraints on the absolutist powers in traditional China.[9]

As argued by Shiga, jurisprudence does not grow out of a legal regime where neither customs nor precedents formed an external and binding legal basis for a magistrate's ruling (Shiga et al, p.13-15). Liang Ziping make similar points on what he termed as an insurmountable gulf between private and customary rules and formal laws in traditional China. The absence of such a feedback loop leads to spurts of these institutional innovations that peter out and remain localized in traditional China. Perhaps an understanding on the roots of these problems should be sought beyond the mere

[9] For some examples of monetary and financial innovations in traditional China, see the relevant chapters in Goetzmann and Rouwenhorst. For Chinese business organization, see Faure (1996) and Ma 2004b. For examples of state infringement of private property rights in traditional China, see Deng, chapter 1.

intellectual sphere and placed in the large historical context of political structures of a centralized empire in China versus political fragmentation and separation between church and state in Europe. Understanding the historical roots of these issues is highly relevant to our interpretation of long-term economic growth or lack thereof in traditional China.

Summary

Our debate on the "Great Divergence" should integrate the divergent traditions in legal traditions and institutions between China and the West in the early modern period. To the extent that those institutional and epistemological elements that underpinned the legal revolution in the 11th and 12th century – the separation between Church and the state, the emergence of an independent territorial jurisdiction, the pursuit of transcendental, objective and rectifiable standards – were also relevant, as argued by Toby Huff, for the rise of a scientific revolution in early modern Europe, one needs to take seriously the linkage between legal institutions and the origins of the industrial revolution. The divergent legal traditions are not singular phenomena but rather could be the historical outcome or derivative of contrasting differences in the political and social structures, namely, the political fragmentation and separation between religion and secular forces in the West and the dominance of a centralized bureaucratic empire in China.

It is important to note that the relative efficiency hypothesis of divergent legal traditions is a positive not a normative statement. Nor is it a verdict against the relative merits of comparative civilizations or multiculturalism. The Western experience shows that a private social order not only constitutes the evolutionary basis for public institutions but also continues to play an indispensable role even in modern economies. In China, the inherited cultural and institutional endowments are essential to the making of economic miracles. The long experience of social networks, communities and informal institutions accumulated in China helped reduce transaction costs and supplied trust to enable economic growth to occur in the 19th and 20th centuries even before the clarification and reform of

formal rules and institutions. The traditional preference for flexibility over fixed rules may have helped Chinese reform in the early 1980s to successfully evade much of the ideological rigidities with little social tension and contributed to the spontaneous emergence of institutional innovations of a highly experimental and often ad-hoc nature often missing in other transitional economies.

However, it is mistaken to attribute modern economic growth to purely East Asian roots. What probably distinguished East Asia from the rest of the developing world today, or what Max Weber had failed to anticipate, is her learning capacity to absorb not only Western technology but also formal institutions - from legal system to state-building and to monetary regimes. One of the pillars of the Meiji reform in Japan was the adaptive introduction of Western legal institutions ranging from the Constitution to commercial law, to modern accounting and joint stock corporations. In China, legal reform was delayed until after the turn of the 20th century when the first set of civil and commercial codes were being compiled with the aid of Japanese legal specialists. But with the collapse of the Qing empire and the nation thrown into civil disorder after 1911, the implementation of legal and institutional reform was severely curtailed. As I argued elsewhere, much of the economic divergence in today's East Asia could be traced to the differential patterns of political and institutional response to the Western challenge in the mid-19th century (2004a).

Clearly, the administrative nature of Chinese traditional justice continues to exert a dominant influence on contemporary Chinese legal apparatus under the garb of a Western Civil Law regime. The fact that economic growth occurred largely in the absence of rule of law during the last two decades should not be viewed as a vindication of its irrelevance. On the contrary, Chinese economic reform borrowed and used ready-made institutions founded on those legal concepts such as joint stock corporation to modern contract law that had taken centuries to evolve in Western Europe. Eventually to sustain the growth beyond the stage of institutional adaptation, a transition the rule of law, one form or another, may become imperative for China.

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