Property Rights in Post-Mao China:
Reconciling China’s Growth with Classical Economics
Introduction: Economic, Legal Reforms in the PRC

Since the death of China’s communist revolutionary Mao Zedong in 1976, the political leadership of the People’s Republic of China has been in a continuous though gradual process of reforming China’s laws and legal and economic institutions in the pursuit of higher economic growth and development than had been achieved in the period of Mao’s leadership, under whose hard-line authoritarian, communist government the Chinese people and economy, by all accounts, suffered, (Cameron 375-376). As Peerenboom recounts, PRC leadership “decided that the major problem confronting China was not class struggle but economic growth,” (55). To that end, the reforms enacted have introduced liberal economic institutions, such as markets, company laws, and foreign investment, to the Chinese economy. Chinese leadership, thereby, has consistently brought China’s institutions more in line with those of modern, more developed economies, at least in the gradual and limited sense possible under a nominally communist regime. Indeed, it is Woo’s contention that “the long-run goals of institutional change [in China] are clear, and are found in the economic models of existing market-based economies,” that “economic liberalization becomes a necessary ingredient [to guarantee higher growth],” and that the gradualism found in the legal and economic reforms enacted thus far is the product of “political deadlock and compromises within the CCP [Chinese Communist Party] between conservative reformers and liberal reformers” rather than any “particular theory of reform,” (118, 122-123). The latter point notwithstanding, the reforms have proved themselves successful.

The post-Mao Chinese economy, from 1978 to the present day, has averaged yearly growth of over 9 percent, with “several peak years” of over 13 percent yearly growth, (Dickie n.p.; Hu and Khan n.p.). Comparing these figures with the 2.3 percent annual growth for the world as a whole between 1960 and 1990 and bearing in mind the fact that no economy has
grown faster since 1978, one gets the impression that China’s policies have truly been successful, (Leblang 5; Putterman 1064). But, despite its positive record of liberal reforms and growth, China is somewhat of an economic anomaly as, until quite recently, China has not had clear legal provisions for what many might consider one of the most basic, even primordial, requirements for sustained economic growth: legally defined and protected property rights, (Hoskins and O’Driscoll 2; Oi and Walder 1; Peerenboom 450, 453). However, it is during the period in question that informal institutions incorporating aspects of property rights arose in China, accounting for the lack of formal property rights, contributing to China’s economic success, and leading to reforms introducing formal property rights to the growing list of Western economic institutions in China.

Classical Views of Property Rights and Modern Reflections

Given China’s situation, just how important are property rights when considering economic growth? If one were to read the works of the classical economic thinkers of the Enlightenment era, such as Hume and Smith, one would find the existence of private property so fundamental to their understanding of economics that it is, in fact, assumed in their arguments, (Hoskins and O’Driscoll 3; Leblang 8). Modern studies of economic growth, as well, see property rights as having a substantial, sometimes deterministic, influence on the economic growth of nations, (Leblang 21; Hoskins and O’Driscoll 3; Peerenboom 450, 453, 459).

In his economic analysis of government, David Hume, as was said above, finds property rights to be so basic a foundation of government that he goes so far as to dismiss the idea that there are any differences in property rights between republican and monarchic governments and, therefore, that these can not have any bearing on the economic growth of nations, (“Of Civil
Hume posits rule of law (a part of which property rights are generally considered) as being requisite for scientific and artistic progress, (117-8). It is in “Of Commerce,” though, that the contribution of property rights to economic growth is most explicitly considered, where Hume argues that the expectation of reward for one’s labors is necessary to bring about economic growth. While comparing the respective benefits and costs to society of a liberal or command economy, Hume states, “It is best policy to comply with the common bent of mankind, and give it all the improvements of which it is susceptible,” and sums his argument with regard to command economies thus:

Where manufactures and mechanic arts are not cultivated, the bulk of the people must apply themselves to agriculture; and if their skills and industry encrease, there must arise a great superfluity from their labour….They have no temptation, therefore, to encrease their skill and industry [in a command economy]; since they cannot exchange that superfluity for any commodities, which may serve either to their pleasure or vanity. A habit of indolence naturally prevails, (260-1).

One sees, then, in Hume’s writing, that without the expectation of increased benefit from one’s increased labor—a major facet of property rights—economic growth seems unlikely if not impossible.

Smith, like Hume, also finds property rights to be a fundamental aspect of society and government, stating, “The first and chief design of every system of government is to maintain justice: to prevent the members of society from encroaching on one another’s property, or seizing what is not their own. The design here is to give each one the secure and peacable possession of his own property,” (Hoskins and O’Driscol 3-4). But it is in his story of the fall of feudalism in The Wealth of Nations that Smith best demonstrates how property rights are fundamental in regard to economic growth as, firstly, landlords were able to operate their farms more efficiently only by privatizing and leasing them, and secondly, that the farmers agreed to
work the landlord’s farms only if they themselves became more secure in their leases. Referring to the growth of commerce across Europe, Smith concludes his story, “Neither of them had either knowledge or foresight of that great revolution which the folly of the one, and the industry of the other, was gradually bringing about,” (257).

Modern theory and research reflects Hume’s and Smith’s ideas regarding the importance of property rights in economic growth. In a “recent review of 21 quantitative studies investigating the relationship between regime type and economic growth,” for example, “Przeworski and Limongi explain that ‘eight [studies] found in favor of democracy, eight in favor of authoritarianism, and five discovered no difference,’” supporting Hume’s similar contention, (Leblang 6). However, in an even greater throwback to Hume and Smith, Leblang’s research, focusing on property rights rather than political regime, “demonstrated empirically that nations that protect property rights grow faster than nations that do no protect property rights,” Leblang adding, “…market activity…does not occur in a vacuum. If a nation wants to grow, then it has to…protect property rights,” (21).

Leblang is not alone in holding property rights to have a substantial influence on economic growth. Economist and sociologist Max Weber, for example, argues, “Economic actors in a market economy require predictability and certainty to be able to plan their affairs and to ensure that they will reap the benefits of their efforts, inventions, and investments,” (Peerenboom 451). Historian Douglas North argues similarly, with the conclusion that, “[l]acking proper institutions and enforceable property rights, developing countries have not been able to take advantage of whatever opportunities for growth do exist,” (Peerenboom 452-3).

One sees the integral role of property rights in economic growth, but how does one then explain China? As Oi and Walder state,
It is widely believed that a market economy requires property rights that are defined with sufficient clarity and enforced with sufficient predictability to encourage individuals and firms to expend effort, plan, invest, and bear risks. These general tenets have not been seriously disputed in the spirited debates about economic institutions in transitional economies. The real disagreements are about specifics. How clear is clear enough? How predictable is predictable enough? What institutional arrangements are capable of ensuring the requisite clarity and predictability and how do we create them? (1)

It is by analyzing China’s institutions from this perspective that one can explain China’s growth.

**Property Rights in the People’s Republic of China**

Property rights in the Western tradition are viewed as a bundle of individual rights, namely, rights to utilization or managerial control of assets, rights to consumption and income flows of assets, and rights to alienate assets or reassign ownership of assets to other parties (Leblang 7; Oi and Walder 5; Putterman 1049). However, by dismantling what is commonly taken as a joint institution into the component parts listed, one can differentiate between *de jure* versus *de facto* ownership; it is through the latter that property rights developed in China, (Putterman 1050) ¹ and it is in regard to these that a passage from Smith’s *Theory of Moral Sentiments* is particularly enlightening:

> The man of system…is apt to be very wise in his own conceit; and is often so enamoured with the supposed beauty of his own ideal plan of government, that he cannot suffer the smallest deviation from any part of it. He goes on to establish it completely and in all its parts, without any regard either to the greatest interests, or to the strong prejudices which may oppose it. He seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges different pieces upon a chessboard. He does not consider that the pieces upon the chessboard have no other principle of motion besides that which the hand impressed upon them; but that, in the great chessboard of human society, every single piece has a principle motion of its own, altogether different from that which the legislature might choose to impress upon it, (139-140).

¹ According to Putterman, *de facto* ownership can be treated as “the right to make such decisions over the use of an asset as have not already been determined contractually by concerned parties,” (1050).
As Oi and Walder recount, “For almost 20 years, reform in China has proceeded through the gradual reassignment of specific property rights from higher government agencies to lower government agencies, or from government agencies to enterprises, managers, families, or individuals,” (6). In general, without transferring the right of alienation, this reassignment has given greater freedom of management and rights to income flows to managerial economic actors, thus introducing the possibility of greater firm efficiency and productivity through the incentive of greater compensation of management, the key relationship that Hume and Smith examined through their analyses of liberal versus command economies and the fall of feudalism and rise of commerce in Europe. Specifically, reassignment has taken place, in a “cascading pattern,” in the forms of “management incentive contracts,” “government-management partnerships,” leasing of public assets, and actual privatization, with the first three being the dominant forms of reassignment for most of the time period concerned and the last gaining popularity more recently, (Oi and Walder 7-10). Without resorting to lengthy descriptions of each form of management-owner relationship, it suffices to say that, as the relationships proceed from one form to the next, management is given greater control over various aspects of business, such as decisions regarding production and sales, and management compensation is governed more by ex ante agreements between government agencies and management, wherein compensation is a function of the performance of the firm, thus giving management the previously mentioned incentives to operate firms in the most profitable manner, (Oi and Walder 7-10). Indeed, according to Groves, Hong, McMillan and Naughton, “the reforms…improved managerial performance in China’s SOEs by strengthening incentives by pay and appointment mechanisms,” (Putterman 1051). Within the sphere of communism and state-owned enterprises, this pattern reaches its zenith in the leasing of firms, wherein management is given complete control over the
operation of the firm in exchange for rents paid to the state, (Oi and Walder 9-10). Also interesting is the effect that these reassignments have had on the greater economic institutional framework, as managers, entrepreneurs, and government officials have shown efforts to continue this gradual process of property rights reassignment into privatization.

As both government and business actors, government officials have taken advantage of property rights reassignments, “‘hollowing out’” the public assets of SOEs, state-owned enterprises, and TVEs, township and village-owned enterprises, by either converting them through government appointment into private businesses, or by using public assets to establish private businesses, (Oi and Walder 17). Lin and Chen, for example, analyze one particular example of a “corporatist village,” a village where the government officials, themselves management of the village enterprise (one form of collective ownership in communist China), put family and friends into other management positions, building what highly resembles a private firm in that, as both management and government officials, those operating the firm can determine compensation and often use that power to assign a greater share of firm income to themselves and their close associates, even though the firms are officially still collectively owned—a situation the Chinese termed “wearing a red hat,” (Oi and Walder 17; Woo 132-134). This “hollowing out” has not escaped higher level Chinese officials, though, as “[i]n December 1995, the State Bureau for the Administration of State Property reported that asset-stripping in the SOE [state-owned enterprise] sector ‘has been about 50 billion yuan [annually] since the early 1980s,’” (Woo 127-8). According to Woo’s calculations, “[t]his would mean that the cumulative loss of SOE assets in the 1983-1992 period was equivalent to some 34 per cent of the net value of the fixed assets in the SOE sector as of 1992,” (128). Another example of the extent to which property rights reassignment has led to greater privatization can be found in the
conversion of collective firms into corporations, due partly to the types of government power abuses mentioned above. As Woo recounts, by legislation passed in 1997, “[a]ll but the thousand largest SOEs and the defence-related SOEs are to be corporatized, with part of their shares sold to employees and the general public,” (128). Thus, the property rights reassignments enacted by Chinese leadership some 25 years ago have been, by increasingly devolving control from the state to individuals, increasingly evolving into institutions resembling those of Western economies. All this notwithstanding, however, the question of how property rights reassignments have affected the growth of the Chinese economy remains.

**The Effects of Property Rights on the Chinese Economy**

Though studies of the effects of property rights reassignments and ensuing privatization on aggregate economic growth in China are nonexistent, as they were to Putterman, the effects of property rights have been quantified in several studies of the major sectors of the Chinese economy, and some of the more illustrative numbers come from China’s agricultural sector, which, as of 1995, accounted for “29 per cent of national income and for 59 per cent of employment,” and where “the shift from teams to households as production units appears to have significantly enhanced production incentives and speeded the release of resources to other sectors,” (Putterman 1048, 1063). Indeed, “econometric studies by McMillan, Whalley, and Zhu and by Lin…attribute 78 and 86.5 per cent respectively of growth in output per unit of agricultural inputs to the adoption of the household responsibility system,” (Putterman 1053). In a related effect, “rural reform freed residents to shift to higher value activities, thus helping to account for growth rates of 4.7, 11.1, 6.4, and 18.9 per cent respectively for forestry, animal husbandry, sidelines and fishery output during 1984-1992,” (Putterman 1053). As Putterman
states, “the consensus is that a change in the assignment of decision-making and revenue rights deserves more credit than marketization or other aspects of China’s reforms in explaining agriculture’s faster growth,” (1054).

In industry, the effects have been similar, and “most authors concur that the increasing importance of the so-called “non-state” sector…has been a major contributor to growth, with TVE and COE total factor productivity (TFP) growing at two to three times the SOE rate,” (Puterman 1055). More specifically, one author of a study regarding the effects of property rights in China’s industrial sector found that “growth of total factor productivity in the SOE sector accelerated from 0.9 per cent during 1957-78 to 5.5 per cent per annum during 1979-1985,” with the numbers of other authors falling “within the range of 2 to 4 per cent,” (Puterman 1056). Other studies show the same links between property rights reassignments and growth. Two studies by Groves et al., for example, “find links between grants of enterprise autonomy, use of bonuses, more temporary employees…and higher enterprise productivity, and evidence that competition for managerial positions had improved enterprise performance,” (Puterman 1056). Similarly, Jefferson, Zhao, and Lu “find that in both the SOE and TVE sectors, managers of less profitable enterprises were more likely to be put on more autonomous, incentive-based contracts, and that when the selection bias inherent in this relationship in controlled for, those contracts are found to lead to greater productivity,” (Puterman 1056). Clearly, the incentives produced through the reassignment of property rights has been successful in bringing about greater economic growth, however, one cannot overlook the effects that the reassignment of property rights has had on larger Chinese institutions that will have even greater bearing for China’s economic future as, for example, on March 14 of this year, the Chinese legislature
amended the constitution to provide legal protection for private property, (“Ideological Acrobatics,” n.p.).

Conclusion

One sees, then, that despite the fact that China’s property rights had not been clearly delineated until quite recently, the *de facto* privatization that had been introduced through the reassignment of property rights—the devolution of specific property rights from the state to individuals—had filled this vacuum left by the lack of formal property rights. These property rights gave economic actors the incentives needed to make production more efficient, contributing to China’s economic growth over the last quarter century, following the economic theories of Hume, Smith, as well as those of modern scholars writing about the influence of property rights on economic growth.
Works Cited


