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Foreword

Introduction to Decentralization and Development

Shitong Qiao[†] & Richard A. Epstein^{††}

On March 14–15, 2017, a group of Asian and American scholars working in the areas of law, economics, and political science gathered at the University of Hong Kong Faculty of Law. They debated and discussed decentralization and development at a conference cosponsored by New York University’s Classical Liberal Institute and the University of Hong Kong Faculty of Law’s Centre for Chinese Law. What does decentralization mean? How do we best measure decentralization? Is interjurisdictional competition a race to the bottom or a race to the top? Is decentralization desirable in China or other jurisdictions?

This symposium contains papers presented at the conference, in which authors take various approaches to the relationship between decentralization and development: one group of scholars takes a universal and theoretical approach; while the second group of scholars offers original case studies from China, exploring decentralization and its implications on development. It is worthwhile to stress at the beginning that these Chinese case studies challenge and enrich the general theories on decentralization and development—just as Barry Weingast and Yingyi Qian coined the phrase “market-preserving federalism” over two decades ago to capture the institutional practices in

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China.¹ In so doing, they triggered a long-lasting debate on federalism and development.² We thank the editors of *Minnesota Law Review* for their tremendous partnership and professional work in rounding out these symposium pieces for publication.

Friedrich A. Hayek—the leading classical liberal thinker of the twentieth century, whose legacy is still shaping theory and practices around the world—is the main inspiration of this symposium. According to Hayek,

If we can agree that the economic problem of society is mainly one of rapid adaptation to changes in the particular circumstances of time and place, it would seem to follow that the ultimate decisions must be left to the people who are familiar with these circumstances, who know directly of the relevant changes and of the resources immediately available to meet them. We cannot expect that this problem will be solved by first communicating all this knowledge to a central board which, after integrating all knowledge, issues its orders. We must solve it by some form of *decentralization*.³

The first question we should ask is what decentralization means. Decentralization can happen in many different contexts. It can happen between the state and individuals, such as decentralizing land-use decisions to individual property owners;⁴ between the state and market entities, a prime example of which is the delegation of legal institution building by the Chinese cen-

1. See Barry Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 J.L. ECON. & ORG. 1, 1 (1995); Yingyi Qian & Barry R. Weingast, *Federalism as a Commitment to Preserving Market Incentives*, 11 J. ECON. PERSP. 83 (1997) (offering a second-generation economic theory of federalism).

2. See, e.g., Gabriella Montinola et al., *Federalism, Chinese Style: The Political Basis for Economic Success in China*, 48 WORLD POL. 50, 56 (1995); Chenggang Xu, *The Fundamental Institutions of China's Reforms and Development*, 49 J. ECON. LITERATURE 1076, 1105 (2011). For a critique of market-preserving federalism, see generally Hongbin Cai & Daniel Treisman, *Did Government Decentralization Cause China's Economic Miracle?*, 58 WORLD POL. 505 (2006); Lizhi Liu & Barry R. Weingast, *Taobao, Federalism, and the Emergence of Law, Chinese Style*, 102 MINN. L. REV. 1563, 1569–73 (2018); Xiaobo Lü & Pierre F. Landry, *Show Me the Money: Interjurisdiction Political Competition and Fiscal Extraction in China*, 108 AM. POL. SCI. REV. 706 (2014); Jonathan Rodden & Susan Rose-Ackerman, *Does Federalism Preserve Markets?*, 83 VA. L. REV. 1521 (1997); Xiangyu Shi & Tianyang Xi, *Race to Safety: Political Competition, Neighborhood Effects, and Coal Mine Deaths in China*, 131 J. DEV. ECON. 79 (2018).

3. Friedrich A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 524 (1945) (emphasis added).

4. See Richard A. Epstein, *Positive and Negative Externalities in Real Estate Development*, 102 MINN. L. REV. 1493 (2018).

tral government to Taobao, the biggest online commercial platform in the world;⁵ and between different levels of government.⁶

Richard Epstein addresses the relationship between decentralization and development in the context of land-use law and offers a conceptual explanation of how to make sound land-use development decisions in the face of the pervasive positive and negative externalities from a comparative perspective, with special emphasis on English and American law.⁷ How should common interests in high-population-density regions be coordinated? One approach is top down, where centralized state authorities make the allocative decisions. The alternative approach is decentralized decision-making. Epstein argues that the state should simply set and enforce boundaries between strangers, and let multiple parties decide privately whether to pool or to separate their activities.⁸ Starting with the single-owner paradigm, in which no externalities are possible, and moving to discussions on zoning and affordable housing mandates, Epstein explains why a system of decentralized property rights and private regulations controls most of the negative externalities while capturing most of the positive externalities.⁹

Lizhi Liu and Barry Weingast move forward from “federalism, Chinese style” to “law, Chinese style,” by which they mean private actors devising new institutional rules in China.¹⁰ In a country with neither Western-style democracy nor an independent judiciary, they explore the best way of achieving credible commitments in market transactions—and the role being played by a private technology firm. Taobao is China’s dominant online trading platform, with over four hundred million users. It “is not simply an exchange platform, but one in the process of develop-

5. See Liu & Weingast, *supra* note 2.

6. See Yun-chien Chang & Ke Xu, *Decentralized and Anomalous Interpretation of Chinese Private Law: Understanding a Bureaucratic and Political Judicial System*, 102 MINN. L. REV. 1527 (2018); Kevin E. Davis, *Data and Decentralization: Measuring the Performance of Legal Institutions in Multilevel Systems of Governance*, 102 MINN. L. REV. 1621 (2018); Roderick M. Hills, Jr. & Shitong Qiao, *Binding Leviathan: Credible Commitment in an Authoritarian Regime*, 102 MINN. L. REV. 1593 (2018); Shitong Qiao, *Rights-Weakening Federalism*, 102 MINN. L. REV. 1673 (2018); Ilya Somin, *Foot Voting, Decentralization, and Development*, 102 MINN. L. REV. 1651 (2018).

7. Epstein, *supra* note 4.

8. *Id.* at 1494.

9. *Id.* at 1524–25.

10. Liu & Weingast, *supra* note 2, at 1574–76.

ing a modern legal system that enforces contracts, resolves disputes, and prevents fraud.”¹¹ Liu and Weingast argue that “development of law, Chinese style, parallels previous instances where the central government delegated reform authority during the reform period from the early 1980s through the early 1990s.”¹² Moreover, the emergence of Taobao’s national market overcomes internal trade barriers, an inherent problem with market-preserving federalism that has been raised by scholars.¹³

Other scholars examine decentralization in the context of allocation of authority between different levels of government. Kevin Davis points to the difficulty in measuring the performance of legal institutions in multilevel systems of governance, which, in turn, likely affects the accountability and responsiveness of the institutions being measured.¹⁴ Davis focuses especially on the challenges to producing indicators that isolate the performance of individual legal institutions, particularly subnational institutions.¹⁵ These challenges come from main sources: one is that governance outcomes are determined jointly by multilevel institutions instead of institutions operating at a single level; the other is the lack of interest by suppliers of such measurement indicators.¹⁶ Davis argues that while “there are several examples of legal performance measures that cover subnational territories,” those indicators are “not . . . good measures of the performance of any particular subnational legal institution.”¹⁷ In a broader sense, Davis points to the complication of decentralization and the potential tragedy of the regulatory commons in multilevel governance.

One natural appeal of a decentralized system is that individuals are able to vote by foot. Albert O. Hirschman’s classical book *Exit, Voice and Loyalty* raises the ever-intriguing trade-off between exit and voice.¹⁸ Following his previous work criticizing

11. *Id.* at 1565.

12. *Id.*

13. *See, e.g.*, Rodden & Rose-Ackerman, *supra* note 2.

14. *See generally* GOVERNANCE BY INDICATORS: GLOBAL POWER THROUGH CLASSIFICATION AND RANKINGS (Kevin E. Davis et al. eds., 2012); THE QUIET POWER OF INDICATORS: MEASURING GOVERNANCE, CORRUPTION, AND RULE OF LAW (Sally Engle Merry, Kevin E. Davis, & Benedict Kingsbury eds., 2015).

15. Davis, *supra* note 6, at 1623.

16. *Id.*

17. *Id.* at 1633.

18. ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES* (1972).

ballot voting,¹⁹ Ilya Somin argues that “the best way to create new development is to facilitate foot voting by decentralizing political power and breaking down obstacles to mobility.”²⁰ He argues that foot voting promotes development both in a federal system and across international boundaries.²¹ More specifically, Somin argues that migration can enable effective exploitation of “place premiums”—situations where a given individual is likely to be more productive in one location than another, and explores mechanisms that would facilitate foot voting both domestically and internationally.²²

In contrast, Roderick Hills and Shitong Qiao continue their exploration of the interaction between national and subnational governments and the political institutions behind interjurisdictional competition.²³ Their symposium paper studies why Chinese local officials, who are subject to frequent transfer by the central government, are unable to make a credible commitment to any development projects they try to initiate during their terms.²⁴ Hills and Qiao describe how the problem of credible commitment posed by China’s cadre transfer policy, and, more generally, the Chinese Communist Party’s distrust of divided power, have led to excessive municipal debt in China. They propose three new institutional solutions for resolving the credible commitment problem of China’s authoritarian regime, including using decentralized homevoters instead of centralized institutions as local government monitors.²⁵

Other participants question whether decentralization is necessarily desirable in the first instance. Yun-chien Chang and Ke Xu offer one of the very first large-scale empirical studies of Chinese judicial decisions to test how local courts apply national laws in adjudicating property disputes.²⁶ Their Article points to a central question in law and development: whether and how the past decades of codification of private law in China—including

19. See ILYA SOMIN, *DEMOCRACY AND POLITICAL IGNORANCE: WHY SMALLER GOVERNMENT IS SMARTER* 80 (2d ed. 2016).

20. Somin, *supra* note 6, at 1651.

21. *Id.* at 1652.

22. *Id.* at 1653–57.

23. Roderick M. Hills, Jr. & Shitong Qiao, *Voice and Exit as Accountability Mechanisms: Can Foot-Voting Be Made Safe for the Chinese Communist Party?*, 48 COLUM. HUM. RTS. L. REV. 158 (2016).

24. Hills & Qiao, *supra* note 6.

25. *Id.* at 1614–19.

26. Chang & Xu, *supra* note 6.

contract law, property law, tort law, and the ongoing legislation of the civil code—will shape the Chinese economy and society at large. They argue that the answer largely depends on how nationally promulgated statutes are interpreted by local Chinese courts.²⁷ Their empirical investigation reveals that decentralized interpretations follow geographic boundaries, given the power of non-legal-institutional constraints that operate within the jurisdictional boundaries of the thirty-one provincial high courts. These anomalous interpretations present no clear patterns and create unpredictability that economic actors, especially those who seek to operate on a national stage, cannot plan around. Chang and Xu argue that decentralized judicial interpretations therefore are highly likely to harm economic development in China.²⁸

Finally, Shitong Qiao examines the gap between national land laws and local land reforms in China and investigates whether interjurisdictional competition protects land rights in China.²⁹ His empirical investigation reveals that local governments take far more land than the national government has authorized.³⁰ These local governments alternatively violate, tweak, or challenge the national law. His examination of the impact of interjurisdictional competition on the development of local land institutions demonstrates that local governments are weakening individual land rights in order to attract mobile capital. Qiao therefore calls decentralized land reforms in China rights-weakening federalism.³¹ Qiao further argues that the structure and power of local governance—the balance between land and capital—matters much more than competition per se, so that the proper question to ask with respect to interjurisdictional competition is: Who shapes and benefits from the competition?

Many of the symposium papers use Chinese institutions as case studies, killing two birds with one stone. One key to China's economic development miracle over the past four decades has arguably been decentralization,³² which makes it the perfect jurisdiction for studying decentralization and development. As the largest developing country in the world, China is still experiencing ongoing institutional experiments throughout the country.

27. *Id.* at 1560–62.

28. *Id.*

29. Qiao, *supra* note 6.

30. *Id.* at 1685.

31. *Id.* at 1675.

32. *See* Xu, *supra* note 2, at 1081–82.

These separate events provide rare opportunities for us to observe how decentralization works in practice, and it provides a stimulus that should trigger further theoretical work on the overall process of innovation. Our discussions also reveal useful lessons for China's reform in different spheres of activity, including the Internet, land use, the judiciary, and local governance.

Readers of this symposium will have to make their own judgments on whether we have made the debate on decentralization clearer or muddier. As this symposium demonstrates, decentralization can happen in different forms, in different contexts, and on different time frames, where the multiplicity of outcomes are difficult to measure. The increasingly blurry boundaries, competition, and interactions between different levels of government also make it hard to evaluate the impact of decentralization on development. Individual or decentralized decisions often have wide-ranging impacts on the whole system.³³ As Hayek wrote immediately following the paragraph cited at the beginning of this Foreword:

[Decentralization] answers only part of our problem. We need decentralization because only thus can we ensure that the knowledge of the particular circumstances of time and place will be promptly used. But the "man on the spot" cannot decide solely on the basis of his limited but intimate knowledge of the facts of his immediate surroundings. There still remains the problem of communicating to him such further information as he needs to fit his decisions into the whole pattern of changes of the larger economic system.³⁴

Hayek argues that the price system meets this challenge.³⁵ He is undoubtedly right that the price system solves many problems, but surely it does not solve all these problems given that competitive solutions are not easy to come by for, say, network industries or pollution control. But at least some of these problems are amenable to decentralized solutions, which will have to rely heavily on various markets and their accompanying price mechanisms to guide and coordinate both private and government actors. We hope this symposium will invite scholars to rethink decentralization and development in today's ever changing political and technological environment. We also hope that this collection of papers proves useful to policymakers and other

33. See, e.g., Heather K. Gerken, *Federalism as the New Nationalism: An Overview*, 123 YALE L.J. 1889 (2013) (organizing a modern accounting of federalism into five observations).

34. Hayek, *supra* note 3, 524–25.

35. *Id.* at 525.

practitioners making decisions about the allocation of resources and powers in achieving development goals.