China Analysis 88
June 2011
www.chinapolitik.de

Experience First, Laws Later:

Experimentation and Breakthroughs in the Restructuring of China's State Sector

Sebastian Heilmann

Sebastian Heilmann
Professor of Government / Political Economy of China
Trier University, 54286 Trier, Germany

E-mail: china_analysis@chinapolitik.de

[Published in Jean Oi (ed.), Going Private in China: The Politics of Corporate Restructuring and System Reform. Stanford/Baltimore: Shorenstein Center / Brookings Institution, 2011, 95-118.]

5 Experience First, Laws Later

EXPERIMENTATION AND BREAKTHROUGHS IN THE RESTRUCTURING OF CHINA'S STATE SECTOR[1]

Sebastian Heilmann

The reorganization of large state-controlled enterprises arguably has been the toughest job for Chinese policymakers over the last three decades. State-sector reorganization has been subject to very strong political inertia and opposition that are inherent in a socialist and post-socialist political economy. Traditional socialist ideology stresses the dominant role of public ownership, the central position of the industrial working class in the political economy, and the redistributive goals of economic planning and policy-making. All three ideological elements have continued to be highly contested issues in the politics of corporate restructuring in China. Each of them became a line of defense for powerful interest groups. The managers of state-owned enterprises (SOEs) lobbied their political-bureaucratic superiors to keep budget constraints soft and access to preferential loans open. Public-sector workers and pensioners protested against the risks, burdens, and manipulations they faced with the reorganization or close-down of their long-time workplaces. Containing the social repercussions of SOE restructuring and dampening ideological controversies about the appropriate extent of state control in the economy therefore have been pushed to the top of policymakers' agenda since the 1980s.

In addition, contrary to what one might expect, decision-making at the apex of China's political system is hampered by informal consensus rules.

1 The research for this article was supported by the German National Research Foundation (DFG). The author is especially indebted to Jean Oi for encouraging this study of the state sector and to Nancy Hearst, the librarian of Harvard University's Fairbank Collection in the Fung Library, who provided precious sources and proofread an initial version of the manuscript.

Controversial policy proposals are rarely pushed through by a lone decision by the Communist Party's general secretary or by a majority vote in the Politburo. Rather, they are postponed until a consensus among major policy-makers can be reached. Such decision-making rules are not conducive to producing determined and consistent national policies in a highly controversial and ideologically charged policy domain such as state-sector restructuring. Moreover, institutional rivalries among entrenched national bureaucracies (more or less reformed socialist-era commissions and ministries) and the emergence of increasingly assertive new players in national policy-making (in particular the Standing Committee of the National People's Congress as a legislative body; the Supreme People's Court as a quasi-policymaker through judicial interpretations for insolvency proceedings; and since 2003 the State-Owned Assets Supervision and Administration Commission [SASAC] as a new regulatory body) complicated the formulation and revision of restructuring policies.

Against this background of reform inertia, one central puzzle in China's restructuring efforts is how policymakers managed to overcome the constraints and promote the new policies and institutions that changed the rules of the game. Differences in initial conditions and economic structure may explain why China had the potential to introduce market competition with less disruption than the former socialist economies of Eastern Europe.[2] But initial conditions do not determine how effectively policymakers make use of them. In order to explain China's remarkable "adaptive efficiency"[3] in promoting growth, investment, and trade, changing the behavior of state and market actors, and establishing new economic institutions we must take a careful look at the policy processes that have propelled restructuring in spite of the severe reform inertia.

In SOE reform, as in most domains of China's economic reform since 1979, policy changes were produced according to a process whereby central policymakers encouraged local experimentation to generate novel policy options that could then be fed back into national policy-making. Experimentation served as a crucial means for avoiding policy deadlock and reducing the frictions and delays characteristic of top-level consensus-building and inter-agency accommodation. It helped to reduce the risks in policy-making, stimulate policy entrepreneurship, and contribute to the

2 For an influential analysis along these lines, see Jeffrey Sachs et al., "Structural Factors in the Economic Reforms of China, Eastern Europe and the Former Soviet Union," *Economic Policy* 9, no. 18 (April 1994): 102–45.

3 See Douglass C. North, *Institutions, Institutional Change and Economic Performance* (New York: Cambridge University Press, 1990), 80–81; *Understanding the Process of Economic Change* (Princeton, NJ: Princeton University Press, 2005), 154.

fine-tuning of policy content and implementation. In policy domains in which new actors, interests, and ideologies entered national policy-making, such as foreign trade and investment or private business during the 1990s, experimentation went beyond incremental adaptations and resulted in transformative departures marked by the emergence of novel policy regimes with new constellations of actors, interests, institutions, and ideologies.[4]

Proceeding from "experimental points" (*shidian*) to broader policy innovation was possibly the only way to introduce a vital pioneering element into the rigidly organized polity. The "experimental point" method was capable of contributing to substantial policy innovation over time precisely because it fit so well into the logic of the Chinese political economy with its mixture of rigid formal-hierarchical and more flexible informal-institutional elements. Experimentation served as a method for political management of rapid change that utilized, rather than destroyed, existing formal and informal rules of the policy-making game to introduce a strong innovative element into the bureaucratic polity.

China's ability to experiment with policy prior to the actual formulation and passage of policies or laws allowed a highly unusual degree of policy flexibility. It is well known that in China's state sector powerful vested interests and socialist ideological concerns stood in the way of transformative change. From 1978 to the mid-1990s, recurrent rounds of experimentation resulted in protracted policy tinkering with bureaucratic and financial incentives or formal corporate reorganization, yet without touching the politically protected and financially privileged status of the SOEs in the economy. Incrementalist reforms minimized political conflict and social disruption but perpetuated the misallocation of resources, subsidies, and loans and therefore were wasteful in narrow economic efficiency terms. Seen from the perspective of the evolution of the political economy and policy learning, however, the contribution of experimental tinkering to transform the policy-making context of local and central decision-makers was essential. It provided test-runs for novel administrative and business practices, initiated learning processes and behavioral changes, and thereby undermined entrenched ideologies, attitudes, and interests. In short, policy experimentation helped to "smuggle changes into the system."[5] Experimental tinkering in combination with transnational push factors such as the Asian financial

4 For a study of the varying functions, patterns, and effects of experimentation in major economic policy domains, see Sebastian Heilmann, "Policy Experimentation in China's Rise," *Studies in Comparative International Development* 43, no.1 (March 2008): 1–26.

5 This is how Charles E. Lindblom characterizes the tactics of introducing indirect change over time in American politics; see his article "Still Muddling, Not Yet Through," *Public Administration Review* 39, no. 6 (November-December 1979): 517–526, at 521.

crisis and WTO accession negotiations provided the policy planks for broad reform departures in 1997 and 2001.

In the sections below, I will first briefly contrast the distinctive policy cycle that we find in China with the conventional process of policy-making. To examine the implications of the experimentation-based approach for state-sector restructuring, I identify the general constraints inherent in this policy domain. To illustrate what this meant for policy change, I will turn to a case study of bankruptcy regulation, which has been a particularly contested issue for more than two decades. I look at how the changes proceeded but also consider the political and economic drawbacks of state-sector experimentation. In the concluding sections, I expound on how experimentation laid the groundwork for the post-1997 policy breakthroughs and why experiment-based institutional innovation is superior to the synoptic policy-making approaches that are implied in the institutional complementarities framework.

China's Experimentation-Based Policy Process

The Chinese experience in developing and implementing economic reforms differs in fundamental respects from standard assumptions about policy-making. The conventional model of the policy process holds that policy analysis, policy formulation, and embodiment in legislation *precede* implementation. One core principle of policy-making in rule-of-law systems is that administrative implementation must come after parliamentary legislation or executive regulation and must be based on formalized, publicized, and therefore verifiable and actionable general rules. The priority of the law and the principle of law-bound administration basically rule out discretionary and experimental administrative measures in advance of the enactment of laws and regulations. One striking feature of this legislation-centered policy process is that the potential impact of the policies under deliberation has to be assessed *ex ante*, without being able to test the new policies (or at least some key elements) in practice beforehand and thereby obtain realistic information about the potential effects.

In China's reform experience, many successful innovations have been the result of administrative "groping along," that is *experimentation during implementation*.[6] Frequently there was little, if any, policy impact assessment, administrative coordination, and consensus-building in advance of the testing of new policies. Policy analysis and codification came only after experience, and after it could be determined what would work in the administrative reality. This mode of policy-crafting is the main source of the unorthodox regulatory practices and unclarified property-rights regime that have accompanied the strong economic growth in China.[7] Thus, discretionary administrative experimentation *in advance* of legislation plays a crucial role in China's policy process. In general, universal rules are made only after real-life test-runs and after obtaining experience about which ways to handle problems will work in practice. In short: experience first, laws later.

The mode of central-local interaction that we find in China's policy cycle does not easily fit into conventional social-science models of policy implementation and central-local relations. In research on China's reform, administrative decentralization is often cited as the key change that triggered local state activity. However, Chinese reform of governance goes beyond sweeping administrative decentralization and spontaneous diffusion of successful experiments. It requires the authority of the central government. The Chinese pattern of *experimentation under hierarchy* focuses on finding innovative policy *instruments*, rather than defining policy *objectives*, which remains the prerogative of the top political leadership. With regard to the means of reform, the experimental process is decidedly open and regularly leads to decentralized initiatives that are not anticipated by the center. Political actors at various levels thereby become initiators and active participants in the reform drives.[8] But ultimate control over confirming, revising, terminating, and spreading local policy experiments rests with higher-level decision-makers.

In the making of China's economic reform policies, experimentation has been much more prevalent and institutionalized than the available literature suggests. It has provided policymakers with a veritable laboratory for policy innovation. In this laboratory, the constant search for new policy solutions is not driven by the *ex ante* policy debate and impact assessments that are

6 For general features of this mode of administrative experimentation, see Robert D. Behn, "Management by Groping Along," *Journal of Policy Analysis and Management* 7, no. 4 (Summer 1988): 643–63.

7 Sharun W. Mukand and Dani Rodrik, "In Search of the Holy Grail: Policy Convergence, Experimentation, and Economic Performance," *American Economic Review* 95, no.1 (March 2005): 374–83, make a similar basic point, albeit without scrutinizing the particular policy process behind experimentation. For the unorthodox development of China's property-rights regime, see Andrew G. Walder and Jean C. Oi, "Property Rights in the Chinese Economy: Contours of the Process of Change," in Jean C. Oi and Andrew G. Walder, eds., *Property Rights and Economic Reform in China* (Stanford: Stanford University Press, 1999), 1–24.

8 Thomas G. Rawski, "Implications of China's Reform Experience," *China Quarterly*, no. 144 (December 1995): 1155, states that "the mix of top-down initiative and bottom-up reaction is itself a variable element within the reform mechanism."

typical of democratic law-making. Instead, policy adaptation is built into administrative practice and made a permanent enterprise. It is based on the administrative discretion and entrepreneurship exercised by local officials. This clearly contradicts law-based administration. But in developing new and practical policy options, this approach to reform has provided policymakers with a much broader and more flexible range of instruments than the legislation-centered policy processes in democratic polities such as Japan or South Korea since the 1990s.

Experimentation, Inertia, and Complementarities

Almost all crucial economic reform initiatives in post-Mao China were prepared and tried out by means of "experimental points" (pilot projects) before they were universalized in national regulations. This applies to SOE restructuring in particular (see Table 5.1). I need not go into the policy history of restructuring since the crucial steps and advances in restructuring are elaborated in Oi and Han's contribution to this volume.[9] What I want to stress here is the importance of local "experimental point work" and central adoption of "model experiments" for national economic regulation. China's experience with policy-based bankruptcy regulation from 1984 to 2007 is one major example of this type of policy process.

Designed as a response to chronic SOE deficits, the experimental programs of the 1980s were mainly oriented to providing additional incentives and decision-making powers to SOE managers, albeit without transforming the bureaucratic institutional set-up outside of the companies. Reformist experimentation met with strong reservations from parts of the policy-making community, industrial bureaucracies, and the national legislature. In effect, SOE restructuring that aimed at full-scale corporate reorganization turned out to be unachievable during the 1980s and the early 1990s.[10]

In the mid-1990s, an ambitious new attempt to transform SOE operations was undertaken with the "modern company system" (MCS) experimental program. In the face of increasing debts in the state sector, a consensus for thoroughgoing SOE restructuring was taking shape among

9 For brief policy histories of SOE restructuring written by Chinese scholars, see Ding Xiaozhi and Ji Liuxiang, "1978 Nian Yilai Guoyou Qiye Chanquan Gaige Jincheng Ji Xiaolü Pingxi" [Evaluation of the Process and Effectiveness of Property-Rights Reform of State-Owned Enterprises], *Zhongguo Jingjishi Yanjiu* [Research on Chinese Economic History], no.1 (2005): 69-77; Wang Haibo, "Zhongguo Guoyou Qiye Gaige de Shijian Jincheng (1979–2003 nian)" [The Experience of the Process of State-Owned Enterprise Reform (1979–2003)], *Zhongguo Jingjishi Yanjiu*, no. 3 (2005): 103–12.

10 Cf. Murray Scot Tanner, *The Politics of Lawmaking in Post-Mao China* (Oxford: Clarendon, 1999), 167-205.

TABLE 5.1

Application of the "Experimental Point" Method in SOE Restructuring since 1978

Delegation of greater autonomy to enterprises	1978–1980
Delivery of contract profits to the state	1981–1982
Substitution of profits with taxes	1983–1986
Transformation of SOEs into shareholding companies	1984–1997
Bankruptcy regulation	1984–2007
Preparation of a national SOE law	1984–1988
SOE responsibility contracts	1987–1993
Establishment of enterprise groups	1991–
"Grasp the large and let go of the small [SOEs]" (Chongqing experiments)	1994–1995
"Modern company system" (corporatization of large SOEs)	1994–1997
Deepening corporate governance reform in large SOEs	2003–
Complete transfer of the social functions of large enterprises to local governments	2004–2005

Source: Zhongguo Jingji Tizhi Gaige Nianjian, 1988–2006 [Yearbook of Economic Structural Reform in China, 1988–2006] (Beijing: Gaige chubanshe, 1989–2007).

top policymakers. As a result, the new Company Law that was passed in 1993 envisaged the transformation of SOEs into modern business entities with transparent structures of corporate governance, but still shunning the privatization of state assets. Policy implementation became based on "post-law experimentation": MCS experiments were designed to smooth the implementation of a reformist national law. However, experimental points established between 1994 and 1997 revealed how tacit resistance from SOE managers and their supervisory agencies produced a heavily bureaucratized design for experimentation and consequently meager results. An evaluation of MCS implementation in the 100 centrally supervised experimental companies at year-end 1996 concluded that "almost no experimental enterprise had achieved the minimum standards of a modern corporation."[11]

Overall, experimental programs undertaken in the state sector appeared inhibited and clumsy in comparison to the pioneering experimentation that was possible in policy domains driven by rapidly ascending new economic actors such as foreign investors or private business. China's state sector represented a policy domain that remained under the control of vested interests. Established actors of the state sector sought to lock in partial reforms and allow only incremental change. By the mid-1990s, as a result of more than a decade of incremental change, SOE management had moved away

11 Jinglian Wu, *Understanding and Interpreting Chinese Economic Reform* (Mason, OH: Thomson, 2005), 155; *Zhongguo Jingji Tizhi Gaige Nianjian 1995* [Yearbook of Economic Structural Reform in China 1995] (Beijing: Gaige chubanshe, 1995), 138–41; 1996, 222–26.

from the coordinated plan of earlier times, but it was still dominated by the socialist legacy of soft-budget constraints.

A special challenge in the reform of SOEs was the necessity for "comprehensive coordinated reform" (*zonghe peitao gaige*) due to the fact that socialist SOEs were not only firms but, with regard to their extensive social functions (including kindergardens, schools, hospitals, pension funding, administration, and so forth), were comparable to self-contained municipalities. As Oi highlights in Chapter 1 of this volume, this characteristic rendered system restructuring necessary to achieve effective corporate restructuring. Therefore, corporate reorganization and bankruptcy posed many more difficulties than they did in Western political economies because they had to go far beyond the transfer of ownership rights, debt restructuring, or liquidation.[12] There was institutional complementarity but it was to the planned political economy from which China sought to transition. One of the most pressing challenges was the close interrelation between SOE debt and China's state-controlled banking system, which was manifest in the huge amount of non-performing loans. Thus, radical SOE restructuring would possibly lead to massive social unrest and the bankruptcy of state banks. Many crucial institutions in China's political economy had to be reformed in a coordinated fashion so as to contain the social and financial repercussions of SOE reform.

As early as the mid-1980s, selected municipalities were designated as experimental sites for coordinated reform. But local experimenters were not in a position to deal effectively with the overarching institutional deficiencies regarding state functions in the economy or the social insurance system whose transformation was indispensable for meaningful SOE reform.[13] Up to 1997, reforms of the state economic bureaucracy were implemented as a formalistic exercise based on re-naming and re-arranging old structures and redistributing their staff but without transforming government operations.[14] In the mid-1990s, state-sector restructuring appeared to be stuck.

The sluggish policy regime in China's state sector was eventually broken up due to the confluence of a number of developments. As Jung will further discuss in this volume, reformers took advantage of the Asian financial crisis

12 See Charles D. Booth, "Drafting Bankruptcy Laws in Socialist Market Economies: Recent Developments in China and Vietnam," *Columbia Journal of Asian Law* 18, no.1 (Fall 2004): 94–147.

13 Zhang Zhuoyuan, ed., *20 Nian Jingji Gaige: Huigu Yu Zhanwang* [Twenty Years of Economic Reform: Reflections and Prospects] (Beijing: Zhongguo jihua chubanshe, 1998), 65–66.

14 Pan Xining, "Gaige Shidian Chengbai Bian" [Debating the Success and Failure of Experimental Points for Reform], *Fazhan* [Development], no. 2 (1995): 28.

to solve the mounting debt problems. The improved fiscal capacity of the central state also made it possible to compensate the losers from restructuring. Finally, a forceful policy entrepreneur, Premier Zhu Rongji, used this policy window to achieve a reform breakthrough. In 1997 China's central policymakers mustered the determination and means to move beyond incremental reform and to deal with the intertwined policy reforms simultaneously. They adopted a plethora of transformative policies to turn around the SOEs—including large-scale mergers, management and employee buyouts, takeovers of small SOEs by private investors, complete closures, mass layoffs, entry of foreign strategic partners, and exposure to international competition through WTO accession. The impacts of these developments are explored in various chapters in this volume.

The policy breakthroughs of the late 1990s, which displayed the potency of a broad approach to tackle corporate, administrative, and social reforms simultaneously, might be taken as support for the institutional complementarities argument that posits that it is not feasible to achieve systemic restructuring by introducing successive piecemeal reforms. The end result (broad complementary reforms), however, must be seen as very different from the extended piecemeal process (non-complementary) that produced the results. The breakthroughs in SOE restructuring had been prepared by a series of limited reorganization experiments that helped policy-makers and administrators understand the cost and risk structure of SOE reform and craft low-risk policy approaches that would have the potential to work in the Chinese context. The preparatory steps in SOE restructuring thus were segmented and non-complementary. From 1978 to the mid-1990s, SOE restructuring was not implemented as a holistic, universal, or law-based policy package. Rather, it was achieved through a policy-based ad-hoc approach to solve the problems of individual enterprises at an opportune point in time. The policies that were part of the post-1997 breakthrough in restructuring (including the approach of "grasping the large and letting go of the small," which had been tested beforehand in the large diverse state sector of Chongqing municipality in 1994–95) had already been tried out in experimental sites in the preceding years and therefore constituted policy approaches with risks that were regarded as calculable. A series of experimental point programs had already tested the waters and prepared the ground for "proceeding from point to surface" as soon as a policy window opened. Post-1997 restructuring, though still costly, discretionary, and controversial, was thus based on the local knowledge, administrative experience, and policy learning that had been obtained from the earlier decentralized experimentation. China's experience with the regulation of corporate insolvencies is a striking example of this approach.

Defying Bankruptcy Orthodoxy: Insolvency by Policy, 1984–2007

Insolvency regulation can be seen as a major test case for how serious and effective state-sector restructuring was pursued and how it came about at the end of the 1990s. Insolvency provisions are characterized by international organizations and their economic advisors as a central pillar of a modern corporate structure to safeguard the interests of creditors and investors, and as an indispensable instrument for restructuring either through corporate rehabilitation or liquidation, especially in the case of insolvent SOEs in the post-socialist economies.[15] After the Asian financial crisis (1997–99), insolvency and related laws were presented as "vital to economic development and stability" by the international bodies that had to deal with the fallout from the crisis. Under the buoyant economic conditions that had prevailed prior to the crisis, governments had neglected to regulate and administer insolvency effectively.[16] According to a strongly worded G-22 working group report, the Asian financial crisis highlighted

> the critical importance of strong insolvency and debtor-creditor regimes to crisis prevention, crisis mitigation and crisis resolution. Effective national insolvency regimes contribute to crisis prevention by providing the predictable legal framework needed to address the financial difficulties of troubled firms before the accumulated financial difficulties of the corporate sector spill over into an economy-wide payments crisis.[17]

According to this approach, indispensable institutional features of an effective insolvency regime include consistent national legislation that protects the interests of creditors and investors, independent courts that handle insolvency proceedings in a competent and reliable way, and a government that takes a neutral position on bankruptcy filings and proceedings.

China defied this kind of "bankruptcy orthodoxy" in managing state-sector restructuring and instead applied a seemingly inconsistent and ineffective "insolvency by policy" approach during a very long period. From 1984, when the first local experiments with bankruptcy began, until June 2007, when the national law on corporate bankruptcy finally came into effect, bankruptcy proceedings were ruled by experimental and makeshift central and local policies and ad-hoc bailouts (see Table 5.2).

15 Booth, "Drafting Bankruptcy Laws in Socialist Market Economies," 94.

16 Asian Development Bank, "Insolvency Law Reforms in the Asian and Pacific Region," *Law and Policy Reform at the Asian Development Bank* 1 (April 2000): 11-12.

17 "Report of the [G-22] Working Group on International Financial Crises," Basel, October 1998, 9.

TABLE 5.2

China's Approach to Bankruptcy: Local Experiments and Central Regulation

	Local Experimentation	Central Regulation and Law-Making
1984–1986	Four municipalities experiment with bankruptcies based on local initiative and with informal backing by individual central policymakers.	
1986	Formal central approval of local experiments.	National bankruptcy law passed "for experimental implementation."
1986–1993	Law never applied nationally. Instead, selective local experiments are sponsored.	
1991		Supreme People's Court provides extensive judicial interpretation of 1986 law.
1993	Shenzhen adopts local bankruptcy provisions that go beyond the 1986 law.	
1994	State Council circular on trial implementation of new insolvency procedures in 18 cities (experimental points).	Drafting of revised national bankruptcy law is initiated. 1994–2008: "insolvency by policy" approach, based on centralized coordination and government-supported mergers and insolvencies.
1996	SETC/PBOC circular on trial implementation of new merger and insolvency procedures in 56 cities (experimental points).	
1997	State Council supplementary circular on trial implementation of merger, bankruptcy, and re-employment procedures in 117 cities (experimental points).	Newly formed inter-agency "National Leading Small Group" put in charge of coordinating policy-based insolvencies.
1998–	Nationwide application of the 1994, 1996, and 1997 circulars on debt restructuring.	
1994–2002	Local governments issue implementation measures for SOE bankruptcies based on post-1994 central policies.	
2002		Supreme People's Court provides extensive judicial interpretation of bankruptcy regulation (106 articles).
Feb. 2005		National Plan for Enterprise Closures and Insolvencies, 2005–2008.
Aug. 2006		New Bankruptcy Law adopted, entering into effect in June 2007.
2008	Deadline to terminate policy-based bankruptcies and to make the transition to law-based bankruptcy regulation.	

Sources: Compiled by the author based on coverage in Chinese media and on Xianchu Zhang and Charles D. Booth, "Chinese Bankruptcy Law in an Emerging Market Economy: The Shenzhen Experience," *Columbia Journal of Asian Law* 15, no.1 (Fall 2001): 1–32; and Charles D. Booth, "Drafting Bankruptcy Laws in Socialist Market Economies: Recent Developments in China and Vietnam," *Columbia Journal of Asian Law* 18, no.1 (Fall 2004): 94–147.

The regulation of bankruptcies has belonged to the most controversial issues of economic policy-making in China, starting in 1983 when the issue was first brought onto the policymakers' agenda. Controversies revolve around safeguarding state assets in liquidations and reorganizations and, even more pressing from a political perspective, containing the social and financial repercussions of SOE insolvencies. Dealing with massive unemployment and re-arranging the social functions of SOEs (the provision of pensions, health care, housing, schools, kindergartens, and so forth) proved to be an extremely difficult task that required huge budgetary outlays and a bundle of reforms beyond simply firm insolvency.

The political controversies and drafting processes surrounding the 1986 "Experimental Bankruptcy Law"[18] and the finalized 2006 "Bankruptcy Law" are rather well documented in Chinese and Western research.[19] However, one of the most striking and under-explored aspects of Chinese bankruptcy regulation is the extensive use of centrally sponsored, locally implemented experimentation to find ways to deal with the social and fiscal repercussions of thousands of SOE insolvencies. Local experience was used by central policymakers in their arguments about the necessity and content of bankruptcy regulation. Local governments were clearly interested in being relieved of the task of paying endless subsidies to unprofitable and wasteful SOEs. At the same time, they had to worry about the consequences of bankruptcy on their political-administrative power base and potential mass unrest among workers.

The first attempt at national bankruptcy regulation began with ideologically charged political controversies (1983–1986), became stuck in the middle of law-making due to political opposition in the Standing Committee of the National People's Congress (in 1986), and resulted in a compromise "Experimental Bankruptcy Law" (1986) that was applied only in selected localities and enterprises and never nationwide. Bankruptcy regulation therefore was in a state of limbo until a centrally sponsored policy push introduced a new phase in 1994.

From 1989 until 1993, China's courts accepted only about 1,150 bankruptcy cases whose outcomes are not documented in detail. However, in the early 1990s, rapidly mounting state enterprise debts and debt chains among enterprises and state banks emerged as a top-priority problem among policymakers who shared the view that a turn-around and reorganization of the SOEs was needed. Led by the major economic policymaker of the 1993–2002 period, Zhu Rongji (vice premier 1993–98, premier 1998–2003), it was

18 Official title: "Enterprise Bankruptcy Law (for Experimental Implementation)."

19 Tanner, *The Politics of Lawmaking in Post-Mao China*, 135-66; Booth, "Drafting Bankruptcy Laws in Socialist Market Economies."

decided to begin drafting a new national bankruptcy law that would support the new strategic goal of establishing a "socialist market economy," as laid down by the Communist Party's Central Committee in fall 1993. Zhu started a virtual crusade against debt chains among SOEs and state-owned banks and managed to raise the issue to the top of the national economic agenda. In this undertaking, he apparently enjoyed strong backing from a broad spectrum of top-level policymakers, all of whom agreed that something had to be done about the debt chains. At the same time, however, there was no consensus about how the drastic restructuring should proceed. In this political context, the "experimental point" method proved to be an approach that could break the national policy-making deadlock.

Starting in fall 1994, a series of central government circulars initiated a new wave of local bankruptcy experiments, based on what Charles Booth aptly terms an "insolvency by policy" approach:[20]

- In August 1994, the State Council decided to initiate a "Capital Structure Optimization" program in order to achieve "key breakthroughs" in SOE reform. The measures encouraged raising new capital, company reorganization, staff diversion, and bankruptcy. The State Economy and Trade Commission (SETC) was charged with formulating specific measures in coordination with eight other departments.[21]
- In October 1994, the State Council issued a circular on trial implementation of SOE bankruptcy in eighteen pilot cities (including Shanghai) to test new methods to deal with the resettlement of employees in insolvent industrial enterprises. Land-use rights were to be sold by auction or tender and the proceeds were to be used for resettling laid-off workers.
- In July 1996, the SETC and the People's Bank of China issued a joint circular on trial implementation of mergers and insolvencies of SOEs in fifty-six experimental units. State-owned banks were ordered to play an active role in arranging debt restructuring.

20 This section is mainly based on the highly instructive study by Booth, "Drafting Bankruptcy Laws in Socialist Market Economies," 100-2. See also Xianchu Zhang and Charles D. Booth, "Chinese Bankruptcy Law in an Emerging Market Economy: The Shenzhen Experience," *Columbia Journal of Asian Law* 15, no.1 (Fall 2001): 1-32, esp. 13.

21 See *Renmin Ribao* [People's Daily], August 27, 1994, 2. A sober critique of this program from the perspective of a state bank is found in Hu Liang, "Youhua Ziben Jiegou Shidian Zhong Mianlin De Wenti Ji Jianyi" [Problems We Are Facing in the Experimental Points for Optimizing the Capital Structure and Related Proposals], *Jinrong Yu Jingji* [Finance and Economics], no.9 (1997): 8-9.

- In March 1997, the State Council issued a supplementary circular on trial implementation of merger, bankruptcy, and re-employment measures in SOEs, establishing a National Leading Small Group for restructuring work and officially designating 111 additional experimental units. Coordinated by the SETC, a list of enterprises in the trial cities was drawn up for merger, bankruptcy, and rescue.[22]

Based on these policy documents, the national government issued general guidelines on basic priorities and approaches to handle enterprise insolvencies. Local governments were encouraged to come up with innovative solutions to debt restructuring, mergers, closures, and employee resettlement. In the process, the central government selectively extended substantial financial support to local restructuring. Examples in cases of bankruptcy are provided in Cai's contribution to this volume. Because national social insurance programs were still at an experimental stage when these policies were being initiated, bailouts had to be paid to laid-off workers from local and central coffers or new bank loans. This is an example of how the state intervened to provide an intermediate solution to a longer-term institutional problem that had not yet been resolved, in this case the building of a social security system. As Oi and Han point out succinctly, local officials, caught between financial and political pressures, had to work out "ad-hoc strategies either to cut job losses or to provide for displaced workers." This approach produced "significant local variation in the timing, speed, and content of reform in different cities" and restructuring remained a "patchwork of solutions that pushed the limits of reform but then had to be reined back to accommodate the political as well as the economic realities that existed in different localities."[23]

Based on the stipulations of the above-mentioned policy documents, 2,982 SOE restructuring projects, involving mergers, insolvencies, and re-employment, were commenced between 1994 and 1997. By year-end 1997, 2,393 of these projects were already completed, among which there were 585 enterprise bankruptcies and 1,022 mergers.[24] In 1998 the experience obtained from the experimental implementation of these policy documents was promoted as the basis for nationwide debt restructuring in SOEs. In their

22 See *Renmin Ribao*, April 21, 1997, 1.

23 Jean C. Oi and Han Chaohua, "Political and Institutional Complementarities: The Evolution of Corporate Restructuring in China," unpublished paper, 4.

24 *Zhongguo Qiye Guanli Nianjian 1998* [Yearbook of Chinese Enterprise Management 1998] (Beijing: Qiye guanli chubanshe, 1998), 217, quoted in Ding Xiaozhi and Ji Liuxiang, "1978 Nian Yilai Guoyou Qiye Chanquan Gaige Jincheng Ji Xiaolü Pingxi," 71.

chapter in this volume Oi and Han stress the sequencing of the forms of restructuring. Part of what determined movement to the next phase was gaining sufficient knowledge about what could work, or not, and in what kind of context. Local solutions that appeared socially and economically tenable to the top leadership were promoted as models from which other jurisdictions should learn. Restructuring then gained momentum on a nationwide scale. To accelerate the restructuring process, the Fourth Plenum of the Fifteenth CCP Central Committee (fall 1999) adopted a decision with far-reaching impact that ordered banks to increase their bad-debt write-offs so as to support the merger and bankruptcy of large and medium-sized SOEs and to convert SOE debts into equity (debt-equity swaps). Four national asset management companies were created at that time to re-package and sell the non-performing loans taken over from the state-owned commercial banks.

The policies crafted between 1994 and 1998 and the experience obtained through local implementation experimentation were used as the main national guidelines for dealing with insolvency throughout the country until 2006. The number of insolvencies (including proceedings formally completed by Chinese courts) increased from 1,232 in 1995 to 3,296 in 2000.[25] Overall, the central government pursued a policy of administratively guided and planned bankruptcy that was shaped and refined based on test-runs in a large number of centrally designated experimental units. In the course of this experimentation process, China's insolvency system came to constitute a patchwork of overlapping legal and policy documents: the vague, brief, and outdated 1986 "Experimental Bankruptcy Law"; extensive judicial interpretations by the Supreme Court in 1991 and 2002 to clarify bankruptcy proceedings in China's courts; the series of path-breaking policy decrees, issued by the central government since 1994, to deal with specific methods of debt restructuring, enterprise reorganization, and employee resettlement, mainly based on administrative guidance; and local regulations for corporate insolvency and reorganization, with a pioneering role played by the Shenzhen Special Economic Zone (SEZ) in testing an approach that was more court-based and market-oriented than the widespread administrative-guidance approach.[26] This patchwork of regulations and regulatory practices left many legal gaps but at the same time provided leeway for innovative policy solutions and, most importantly, allowed the process of corporate restructuring to move forward.

25 Supreme People's Court data, quoted in Booth, "Drafting Bankruptcy Laws in Socialist Market Economies," 95 and 101.

26 Booth, "Drafting Bankruptcy Laws in Socialist Market Economies," 97–102.

The evolution of these insolvency policies shows how changing economic and political conditions affect policy-making. Beginning in 1984, probably the most consistently contested legal issue in Chinese bankruptcy regulation revolved around the priorities of debt settlement. In the liquidation of assets, should priority protection be given to creditors or to employees? Chinese policy-making underwent several shifts to deal with this issue, which is particularly delicate in a "socialist market economy" that was expected to respect workers' interests but lacked an effective social security system. Although the 1986 "Experimental Bankruptcy Law" was more creditor-friendly, in reality the administrative practice of dealing with insolvent enterprises favored employees. This was formalized by the 1994 State Council circular that "provided workers' resettlement rights with a first claim on the land-use rights of SOEs in priority to the preexisting rights of secured creditors."[27] This priority scheme was practiced in thousands of cases thereafter. Local experience clearly demonstrated that, due to rising labor protests and public discontent, it was politically inadvisable and practically impossible to reduce employment in state firms without granting locally negotiated more or less generous compensation packages to employees.

Further shifts in the priority scheme occurred in the process of drafting the new bankruptcy law. A 2002 draft placed the burden of providing compensation to employees of insolvent enterprises explicitly on local governments. In a very employee-friendly October 2004 draft that was circulated during heated debates about social inequities in China, workers were given first priority over the rights of secured creditors, thereby going beyond the preferential treatment that workers received under the 1994-99 policy decrees.[28] However, this policy shift in favor of protecting workers was not retained in the final version of the new Bankruptcy Law, adopted in August 2006, that was presented as in keeping with international standards of priority protection for creditors and investors (whereas employee compensation was implicitly arranged through government bail-outs).

This sequence of rather drastic policy shifts makes it clear that experimentation-based discretionary bankruptcy regulation helped to conceal and manage fundamental political-ideological controversies that were at the heart of the delayed law-making. Policy experimentation during the course of twenty-three years allowed recurrent adaptations in the application of the basic priority scheme and thereby helped to avoid open policy conflicts and allowed localities to proceed with restructuring.

27 Booth, "Drafting Bankruptcy Laws in Socialist Market Economies," 139.
28 Booth, "Drafting Bankruptcy Laws in Socialist Market Economies," 140–41.

The unorthodox approach to bankruptcy regulation taken by Chinese policymakers reveals the key guiding role that government organs and administrative actions play in the management of the state sector: "SOE restructuring in China is not a firm-level decision."[29] Formal bankruptcy court proceedings played a minor role during the crucial period of SOE restructuring from 1994 to 2007. Instead, Chinese policymakers used alternative ways to reorganize and turn around the SOEs. Corporate rescue measures were not undertaken primarily through bankruptcy proceedings but through a variety of flexible, inconsistent, but, from a policy-making perspective, much less painful policies. Central and local policymakers shared the view that bankruptcy was neither the most politically palatable, nor the most effective means for dealing with state-sector restructuring. Bankruptcy was merely used as one of several instruments to manage state-sector debts, "along with asset management companies, debt-equity swaps, mergers and acquisitions and other devices, in order to see which works best."[30]

A political imperative to avoid sweeping liquidation of state assets through bankruptcy prevented a comprehensive regulation and propelled a lengthy search for alternative policy solutions to allow state assets and state control in the economy to survive in a new form. The process was not about finalizing policy at certain points in time but about re-shaping available imperfect solutions over and over again until politically acceptable and economically bearable solutions were found and until a conducive economic and fiscal environment made it possible to buffer the social repercussions of more comprehensive restructuring. This lies at the heart of the sequencing process that Oi and Han describe as the pattern of China's corporate restructuring.

Whereas policy experimentation was part of a highly politicized and conflict-ridden process at the central level of policy-making, it was predominantly driven by economic and fiscal exigencies at the local administrative levels. Local policy experimentation contributed to a series of makeshift, half-way restructuring measures since the mid-1980s. Between 1994 and 1997, the number of experimental sites for the management of bankruptcies was constantly expanded. Thereafter, restructuring measures in large SOEs were implemented as part of national plans that stipulated which

29 Oi and Han, "Political and Institutional Complementarities: The Evolution of Corporate Restructuring in China," 3.

30 This is how one experienced lawyer specializing in bankruptcies and mergers, Takuang Chang, characterizes the policy choices made in China. See his "Ten Lessons of the GITIC Bankruptcy," *Asian Wall Street Journal*, January 12, 2001.

enterprises in which industries should be strengthened, merged, or closed down within a certain period. These plans were then carried out by state investment and administrative allocation.[31] After 1998, decentralized experiments in handling insolvencies no longer re-defined national policy goals but contributed to fine-tuning the implementation of employee resettlement and financial arrangements.

For the 2005–8 period, a national plan on closures and bankruptcies was drafted and implemented under the auspices of an inter-agency Leading Small Group for Enterprise Mergers, Bankruptcies, and Staff Re-Employment that had been formed in 1997 to coordinate the restructuring process (see Table 5.2). The 2005–8 plan on bankruptcies was presented as the concluding step in state-guided insolvency management to deal with the "historical burdens" of the SOEs. By this point, experimentation no longer had a role to play. In 2008, policy-based insolvencies were terminated to allow for law- and court-based procedures.

The history of bankruptcy management in China from 1984 to 2007 reveals that two central institutional elements that are taken for granted in "bankruptcy orthodoxy" simply could not be applied to China's political economy: a government that takes a neutral, passive role in insolvency proceedings, and an independent, effective court system.[32] China's insolvency by policy approach generated particular costs and distortions due to government domination in handling the proceedings and fear of the fall-out from corporate bankruptcies.[33] But for central and local policymakers, economic inefficiencies associated with insolvency by policy were part of the "necessary transaction costs to maintain political stability and social cohesion."[34] For them, China's experimentation-based approach to insolvency was an indispensable instrument to promote and manage systemic change. And for political scientists, this approach constitutes an original policy methodology in the restructuring of a socialist economy.

31 For a critical view of this state involvement and an assessment of the transition to a more market-based system, see Wu, *Understanding and Interpreting Chinese Economic Reform*, 191-92.

32 Shahid Yusuf, Kaoru Nabeshima, and Dwight H. Perkins, *Under New Ownership: Privatizing China's State-Owned Enterprises* (Washington, DC: World Bank, 2005), 104.

33 Chen Zhisen et al., "Zhengcexing Guanbi Pochan Hequ Hecong?" [What Course Should be Followed for Policy-Based Closures and Insolvencies], *Dangdai Jingji* [Contemporary Economics], no.11 (2004): 9.

34 Oi and Han, "Political and Institutional Complementarities: The Evolution of Corporate Restructuring in China," 21.

Experimentation and Reform Breakthroughs

In democratic polities, which are characterized by extensive institutional checks, regular electoral and leadership changes, contentious public-policy debate, and a constantly shifting mix of policy priorities, experimentation is subject to narrow limitations:

> By the time a policy has reached the statute books, its content (and often its methods of delivery too) have run the gauntlet of parliamentary debate, media examination, pressure from lobbies and scrutiny by committees. Emerging from this process, the final version of a policy may well incorporate numerous carefully worked compromises, which are by then far too complex to be re-opened.[35]

Under these conditions, pilots that are designed to contribute to developing major policies (*before* binding policy compromises have been made) are rare. Pilots mainly contribute to optimizing methods of implementation for policies whose content has been hammered out beforehand. This is fundamentally different in China, where policy is developed through experimentation and policy departures are prepared and justified on the basis of prior experimentation.

Ambitious structural reformers utilized experimental programs, such as the insolvency, merger, bankruptcy, and re-employment procedures implemented locally from 1994 to 1997, as an effective method to introduce ultimately radical policy goals in the guise of incremental trial measures, thereby reducing risks while increasing the "controllability" (*kekongxing*) of the reforms.[36] Through decentralized experimentation, policy deadlock was frequently overcome and the achievements of the reform were expanded "far beyond what could have been accomplished by top-down initiatives dependent on political consensus among national leaders."[37]

An underrated effect of policy experimentation is in the consequences that come to light only over time and go way beyond the initial intentions of the policymakers who initiated the experimentation. The economic opening of the SEZs and fourteen coastal cities, for instance, was originally justified by Deng Xiaoping as a limited experiment. At that time, foreign trade and foreign direct investment were not intended to increase the competitive

35 Roger Jowell, *Trying It Out: The Role of "Pilots" in Policy-Making* (London: Government Chief Social Researcher's Office, 2003), 9-10.

36 Liu Zhao, Wang Songqian, and Huang Zhanfeng, "Lun Gonggong Guanli Shidian Zhong De 'Shidian Fangfa'" [On the "Pilot Method" in Public Management Practice], *Dongbei Daxue* [Journal of Northeastern University], no. 4 (2006): 281.

37 Rawski, "Implications of China's Reform Experience," 1162.

pressures on China's state enterprises. But over the course of the reforms they exerted increasing influence on the policies crafted for SOE restructuring through selective mergers and acquisitions involving foreign investors. Similarly, China's initial experiments with the transformation of SOEs into shareholding companies were primarily used as an avenue for raising capital. But during the 1990s, policymakers began to use the shareholding system for other purposes: first to change the status of state responsibility in the former SOEs and to find ways to end the state's "implicit social contract with state workers";[38] and second, and belatedly, to improve overall corporate governance with the help of more hands-on shareholders at home and abroad.[39] In these cases, policy approaches that initially appeared rather conservative paved the way for more radical approaches through experimentation and the learning processes they stimulated. Therefore, experimentation often resulted in changes that went beyond the original policy intentions.

Some of the distinctive traits of China's policy-making approach to state-sector restructuring have been pointed out in this chapter. The main components are summarized in Table 5.3. Beyond the growth imperative, no preconceived reform strategy (such as "privatization") was laid down. The means to achieve economic growth and efficiency gains was largely left open. A fundamental difference compared to Japanese and South Korean policymakers since the 1980s is the *time horizon* and the secure political position of Chinese policymakers that facilitated "institutional displacement" and "institutional layering."[40] Newly emerging elements in the political economy "outgrew" the older elements over an extended period. The main precondition for such a policy-making approach, as opposed to policy-making in democratic rule-of-law systems where there are recurrent electoral campaigns, is the long time horizon of the Chinese policymakers who, in the context of the authoritarian polity, do not have to face organized opposition and electoral competition and therefore can afford to wait for conditions to "mature" and for local experience to accumulate. Moreover, the protracted process of policy learning was made possible by the massive growth of nonstate economic activity that reduced the pressures for immediate structural

38 This intriguing point is made by Oi and Han in "Political and Institutional Complementarities: The Evolution of Corporate Restructuring in China," 14–15.

39 See Yusuf, Nabeshima, and Perkins, *Under New Ownership*, 72–73.

40 For a systematic study of incremental but transformative institutional change, see Wolfgang Streeck and Kathleen Thelen, "Introduction," in Streek and Thelen, eds., *Beyond Continuity: Institutional Change in Advanced Political Economies* (Oxford: Oxford University Press, 2005).

TABLE 5.3

Foundations of Policy-making for System Restructuring in China since 1978

Strategy: Beyond the growth imperative, no preconceived reform strategy (such as "privatization") was predetermined. The means to achieve economic growth was largely left open.
Time horizon: The policymakers' secure political position facilitated institutional displacement and institutional layering ("dual track": the new system outgrows the old system) over an extended period.
Experimentation: Decentralized policy experimentation and jurisdictional competition (including technically illegal local policy initiatives) were stimulated and tolerated by the top policy-makers.
Experience first, law-making later: Information about local policy experiments regarded by decision-makers as economically successful and politically acceptable was selectively disseminated and the experiments were expanded "from point to surface" in official pilot programs. Economic legislation usually came as a result of this experimentation process.
Reserve capacities: In periods of "extraordinary politics" (1992–93, 1997–98, 2001–2) when big reform pushes were undertaken by the central policy-makers, Communist Party institutions fulfilled a key role by imposing top-level policy initiatives and institutional reorganization.
Two-level games: Policy-makers played a two-level game during the WTO negotiations so as to intensify transnational adaptive pressures and accelerate state-sector restructuring.

Source: Author.

reform in the public sector[41] and thereby provided Chinese policymakers with an unusually opportune environment for learning and adaptation over an extended period of time.

Opportunistic timing of major policies has been a constant feature of China's state-sector reform. As Jung also stresses, the breakthrough for SOE corporatization came in 1997–98 when top decision-makers were willing to entertain radical restructuring measures due to the shock of the Asian financial crisis. At the same time, economic growth and improved tax collection provided the central government and some local governments with the fiscal means to pave the way for the SOEs to be relieved of their costly "social functions" and to lay off millions of workers at the expense of government coffers. The years of large-scale SOE restructuring after 1998 benefited from a highly opportune economic and fiscal environment that buffered the painful process through government bailouts.[42] The Chinese government was in a position to make determined use of this opportunity not only due to decisive leadership, but also because a plethora of restructuring policies had

41 Specific cases of the variations in leeway that the various localities had in deciding whether to restructure SOEs are detailed in the contribution by Zeng and Tsai in this volume.

42 Cf. Oi and Han, "Political and Institutional Complementarities: The Evolution of Corporate Restructuring in China," 20–21.

been tried out in diverse SOEs and localities beforehand, namely, in the massive, largely ineffective, yet highly instructive 1994–97 experiments introducing a modern company system.

Learning *ex negativo*, that is, by failed experiments, played a crucial role in overcoming the piecemeal approach to restructuring pursued prior to 1997. Negative lessons from failed local experiments, for example those provided by the 1994–97 "modern company system" experimental program, constituted a much less risky mode of policy learning than the enactment of national laws that were not tried out in key elements beforehand and therefore might have produced unintended adverse results. From the perspective of national policy-making, the limited costs attached to the failure of local experiments appear to be much less significant than the experience and knowledge that the failed experiments provide and that may help to avoid national policy disasters. Thus, on the basis of the sobering lessons from earlier restructuring measures, reformers found themselves in the position in 1997-98 to win support for a much more drastic approach to restructuring as soon as the Asian financial crisis opened a window of opportunity for comprehensive SOE reform.

Institutional Complementarities and the Limits of Synoptic Policy-making

Political economy models that stress institutional complementarities call for optimizing the coherence of policy and institutional changes in system restructuring. From this perspective, smartly coordinated restructuring programs are the only way to keep reforms in different policy domains compatible with one another.[43] Yet, as Braybrooke and Lindblom point out in their pioneering and still valid analysis, such synoptic, rationalistic-deductive conceptions of policy-making are generally untenable since they assume, first, that the entire spectrum of alternative policies is somehow known to the analyst and, second, that the ultimate objectives of policy-making are well defined and stable.[44]

Both assumptions are implausible and detached from the reality of policy-making. A central proposition of policy studies that has been bolstered by broad empirical evidence from all types of polities over recent decades states that policy is "made and re-made endlessly. Policy-making is a process of successive approximation to some desired objectives in which what is desired itself continues to change under reconsideration."[45] Interlinked institutional and policy reforms therefore represent "wicked problems"[46] that are characterized by extensive uncertainty about the feasibility and consequences of interventions, pervasive ambiguity, controversy, and indecision on the part of policymakers, unique and rapidly shifting conditions for intervention and interaction, multiple unforeseeable feedbacks, as well as unexpected endogenous and exogenous developments or shocks that can transform the entire playing field within a short period of time.

China's experience with systemic restructuring is characterized overall by an unsynchronized, piecemeal process of reform-making whose *strength is not its coherence but its openness to unexpected and tentative policy solutions that are seized upon when they come up*. Broad-based tinkering effectively enriched and transformed the economic policy know-how of local and central decision-makers and administrators. Protracted policy learning was helped immensely by the massive growth in private and transnational economic activity that lessened pressures for immediate structural reform in the public sector and thereby provided policymakers with an opportune environment for adaptation over an extended period. Reform breakthroughs that contained interlinked restructuring policies came in 1992-93 (the program for market-oriented restructuring), 1997-98 (SOE and financial industry reform), and 2001-2 (foreign trade and investment liberalization) when external push factors (the Soviet collapse, the Asian financial crisis, and WTO negotiations, respectively) propelled top-level policy decisiveness that could build on the diverse experiences obtained through the years of piecemeal tinkering.

From the mid-1980s China's policymakers stated again and again that they saw "comprehensive coordinated reform" as the optimal way to deal with the administrative and welfare impacts of SOE reform. But they could not, and still cannot, build a policy consensus, vision, or agenda about what the state sector should look like at the end of its transformation since sweeping privatization seemed neither desirable nor acceptable to most policymakers. Beyond ultimate policy goals, they also were not sure about the

43 For such an approach, see Fan Gang and Wing Thye Woo, "The Parallel Partial Progression (PPP) Approach to Institutional Transformation in Transition Economies: Optimize Economic Coherence, Not Policy Sequence," *Modern China* 35, no. 4 (July 2009): 352-69.

44 Cf. David Braybrooke and Charles E. Lindblom, *A Strategy of Decision: Policy Evaluation as a Social Process* (New York: The Free Press, 1963), ch. 3.

45 Charles Lindblom, "The Science of 'Muddling Through'," *Public Administration Review* 19, no. 2 (1959): 86, 88.

46 Cf. Horst Rittel and Melvin Webber, "Dilemmas in a General Theory of Planning," *Policy Sciences* 4, no. 2 (June 1973):155-69.

policy instruments. They did not know what types of policies would solve the most pressing deficiencies of the state sector without losing control.

Instead of settling for a deadlock in economic reform as occurred in Brezhnev's Soviet Union, Chinese policymakers tinkered with incoherent, yet still instructive, piecemeal restructuring. In the end, they seized the opportunity for decisive reform only when they were driven forward by exogenous events, felt sufficiently confident to know what might work and what should be avoided due to previous experimentation, and could afford to pursue a proactive fiscal policy that allowed them to placate the losers of state-sector reform through ad-hoc compensation. *The essential fluidity and unpredictability of the policy environment must be taken seriously as a universal constraint for any attempt to design comprehensive reform packages in dealing with institutional complementarities.*

Context-driven expectations are crucial to understanding the distinctive behavior of policymakers and experimenters in China's polity. Whereas policymakers, administrators, and citizens in advanced political economies, such as Japan, tend to view experimental policy departures as risky, destabilizing, and threatening to their stakes in the status quo, political actors in less advanced, yet rapidly growing economies with successful reform records, such as China, tend to display more confidence in the benefits that policy change may bring. Therefore, they may perceive policy experimentation more as a chance than as a risk. Seen from this perspective, in addition to the distinctive policy process, expectations among experimenters and policymakers about the potential gains are a crucial factor that explains the unusual productivity of policy experimentation in China.