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William B. Gamble, "Investing in China: Legal, Financial and Regulatory Risk""

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William Gamble provides a detailed analysis of the legal framework in China covering company, contract, real estate, and tax law. Gamble goes far beyond a list of laws by discussing the economic incentives embedded in laws in the Chinese context as well as offering specific examples of effects on both Chinese and foreign companies. This book should be useful to companies and academics in understanding the changing business environment in China today. This study provides good detail that is not readily available in one place elsewhere, as well as a context, albeit negative, for this information.

This study is certainly timely. One cannot pick up a newspaper or business magazine without finding an article on the rapid growth of foreign investment in China. These trends have gone on for quite some time, but recently accelerated after China joined the World Trade Organization (WTO) in late 2001. Since then China has exceeded even the United States in dollar value of foreign investment. People in many countries—both developing and developed alike—are increasingly fearful of jobs moving to China as it becomes a manufacturing center for the global economy. China appears to be successfully combining skilled labor with low labor costs to produce quality output that can be priced very competitively. The clear message of these trends is that companies cannot afford to ignore China.

From page 1, however, Gamble sends a different message. His broad conclusion is that foreign companies should not invest in China, or, if they do, they must be prepared to deal with monumental and costly risk. In addition, he sees accession to the WTO as continuing, and maybe even compounding, the risks for a long time to come.

Does this mean that those investing in China are ignorant or simply so risk-loving as to qualify as speculators? There is no doubt that investors would benefit from access to more information like that which Gamble provides. On the other hand, the book's timeframe and sources may be biasing the author toward an overly negative view of the economic and legal situation in China.

Gamble's stated approach is to analyze whether or not the economic incentives within the legal system in China are efficient (3–4). He relies heavily on the concept of transaction costs derived from the Coase theorem for this analysis. If transaction costs are low enough, then other problems, such as weak property rights, can be overcome through bargaining to obtain an outcome that allocates resources efficiently. He devotes a chapter each to contract law, bankruptcy and credit systems, the legal structure, securities law, corporate governance, real estate law, and tax law. Each chapter begins with a description of a horror story of how a company got caught in some aspect of the law. Gamble then discusses the current situation relating to the topic at hand and draws out the implied inefficiencies for both Chinese and foreign companies.

One of the weaknesses of this approach is the lack of historical perspective. One gets the impression that we are comparing the situation in China to the U.S. legal system today. This is not a fair comparison. Gamble wrote this book in the late 1990s. He could not have written it much sooner, as most of these laws are quite recent. The fact that China has quickly moved from a nonlegal environment to one that has a legal system and is beginning to incorporate laws into business and personal life is missed. While far from a well-functioning legal environment, this change is remarkable and is probably one of the reasons companies have been willing to invest in China.

Another related problem with Gamble's approach is that his examples are anecdotal, drawn unsystematically from English language sources available on the Internet. Strung together, the impression presented is truly frightening. However, successes do exist: Lenovo Group (formerly Legend) and Hai'er on the Chinese side, and Volkswagen and Coca Cola on the foreign side, to name a few. In addition, China's economy has grown impressively, with households benefiting from higher incomes and consumption. This growth would not be possible without some progress in increasing inputs and efficiency.

Unless, of course, one believes that all of these data are false and that growth in fact has not occurred. Gamble implies this when he references Thomas Rawski's work on China's statistics (92), but elsewhere he seems to accept that China has made economic progress. In any case, Gamble does not deal with the data-accuracy issue in depth, and it is hard to believe that the story is that simple.

One of the book's major themes deals with the decentralization of power that has occurred as a result of numerous market-oriented reforms. Gamble argues that the central government has decided to develop the legal system to regain power over the localities, but that this will fail because members of the Chinese Communist Party (CCP) will block enforcement of laws if it means they will lose power and riches. And, of course, being a one-party system, the CCP does not answer to anyone else. Indeed, many of his examples involve government officials.

This is an important proposition. If there are elements within the Chinese system with the power and incentives to block reform, then eventually the economic progress reaped from earlier reforms will wear thin. Gordon Chang, for example, argues in his book *The Coming Collapse of China* (2001) that the lack of political reform means that China's future is doomed to economic failure. Chang's conclusion follows from an assumption that those with unrestricted political power will always have the incentive and capability to extract rents from or take over, and ruin, the profitable endeavors. Gamble's argument ends up in fundamentally the same place as Chang's.

The problem with Gamble's presentation of this argument is that we have to ask, Who is the "government," and does everyone in the government have the same incentives? For example, while many government officials are CCP members, many are not. In addition, in the central leadership, almost all are CCP members. This suggests the main conflict might be between the central and local levels of both the CCP and government rather than the CCP being the primary obstacle of progress.

The underlying question is whether the benefits of change appear greater than the costs to enough of those people who could block that change, or whether the central leadership can force change despite fears of losses by those affected. For example, there was significant opposition to China joining the WTO from certain central ministries as well as people in local government, as there has been opposition to many of the reforms along the way. Nonetheless, reform has progressed in China beyond what most analysts and Chinese citizens thought possible. At least some of China's leaders, as well as investors, are betting on positive change continuing.

Reference

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