COMMENT

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The Costs of Freedom: New Institutional Comparison of China's and the U.S.'s Responses to the Financial Collapse

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Following the financial collapse of 2008, both China and the United States implemented stimulus plans to minimize adverse market performance. Arguably the vertically integrated institutional structure of China produced a timely and homogenous plan that stimulated market performance. Conversely, the decentralized institutional structure of the United States produced a plan that was delinquent, discordant, and inefficacious. In other words, China's stimulus plan had a closer fit between means and ends.

This Comment compares each country's policy response through the lens of its institutional environment, and explores the relationship between individual liberty and institutional arrangement. Part I lays down a conceptual framework for analyzing how institutional environment affects market performance; Part II synopsizes the institutional arrangements of the United States and China; and Part III comparatively details each country's policy response to the financial collapse. Conclusions and inferences follow in Part IV.

I
TRANSACTION COST ECONOMICS AND NEW INSTITUTIONAL ECONOMICS

Economics measures the irreducible fulcrum of government—"who, whom?"[1]—against market performance.[2] Transaction Cost Economics (TCE) simplifies the relationship between resource allocation and market performance by conceptualizing resource allocation as a series of contractual transactions and categorizing them according to their organizational mode.[3] Thusly, market performance is a function of how resource allocation transactions are ordered.

New Institutional Economics (NIE) expands on the transaction-centric framework of TCE and seeks to explain variations in national market performances by examining the role that social institutions play in determining market organizational modes. Formalistically, the marriage of TCE and NIE provides a conceptual scaffold to

1 *E.g.*, Vladimir Ilyich Lenin, Report To The Second All-Russia Congress of Political Education Departments: The New Economic Policy (Oct. 17, 1921) ("кто кого" literally means "who, whom?" it is more accurately translated as "who will win?"). More precisely, "who gets what, when, and how?" HAROLD LASSWELL, POLITICS: WHO GETS WHAT, WHEN, AND HOW (1935).

2 Market performance is broadly defined as success in providing social benefits.

3 OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 20–22 (1985); Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233, 233–35 (1979).

"identify[] and characteriz[e] alternative ways to organize transactions [and] . . . tools for analyzing the tradeoff among these modes."[4] The underlying rationale is syllogistic: the performance of a market economy depends on market organization; market organization is an expression of institutional environment; therefore, performance of a market economy depends on its institutional environment.

This rest of this section elaborates on TCE and NIE, and explains how they can be used to compare the policy responses of both countries. Particular emphasis is placed on how a country's institutional matrix affects the performance of its political and economic markets.

A. Transaction Costs and Market Organization

"Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses."[5] The neoclassical school examined this relationship between resource allocation and market efficiency by assuming a "frictionless" model where transactions occurred instantaneously and without any cost.[6] While this conceptual simplification was instrumental in developing an understanding of production costs, there are, of course, a myriad of costs appurtenant to market organization, *viz.*, costs incurred in "identifying and matching potential buyers and sellers."[7] Thus, in order to "[d]imensionaliz[e] transactions and examin[e] the costs of executing different transactions in different ways," a more nuanced analytic framework was required.[8]

TCE rejects the orthodox assumption of frictionless markets, and assumes "that individuals have incomplete information and limited mental capacity and because of this they face uncertainty about unforeseen events and outcomes and incur transaction costs to acquire

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4 Claude Ménard, *A New Institutional Approach to Organization*, *in* THE HANDBOOK TO NEW INSTITUTIONAL ECONOMICS 281, 283 (Claude Ménard & Mary M. Shirley eds., 2005).

5 LIONEL ROBBINS, AN ESSAY ON THE NATURE AND SIGNIFICANCE OF ECONOMIC SCIENCE 15 (1932).

6 WILLIAMSON, *supra* note 3, at 19. Three postulates underpin neoclassical economics: (1) individuals pursue their own self-interest; (2) individuals pursuing their own self-interest respond to incentives predictably; and (3) individuals pursuing their own self-interest in mutually voluntary exchange benefits society by driving resources to their most efficient uses. *See* RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 3-10 (7th ed. 2007).

7 Ménard, *supra* note 4, at 306.

8 Williamson, *supra* note 3, at 259.

information."[9] So, transaction costs are appurtenant to making an economic exchange; especially those costs incurred by institutional innovations designed to excise "uncertainty about unforeseen events and outcomes," which results from imperfect information and bounded rationality.[10]

TCE examines such costs according to their mode of economic organization.[11] The two main alternative organizational modes, or "governance structures," are hierarchies (interchangeably: firms, hierarchies, integrated, or centralized) and markets (interchangeably decentralized).[12] The underlying premise is that organization affects market performance because "different internal structures carry distinct administrative costs."[13]

For example, "[i]f the costs of making an exchange are greater than the gains which that exchange would bring, that exchange would not take place."[14] Consequently, "[w]hen information is costly and property rights are poorly protected, contracts become hard to specify and enforce and transaction costs are high."[15] Ergo, "[s]ocieties with persistently higher transaction costs have less trade, fewer firms, less specialization, less investment, and lower productivity."[16]

Conversely, "where institutions increase the certainty that contracts will be honored and property protected, individuals will be more willing to specialize, invest in sunk assets, undertake complex transactions and accumulate and share knowledge."[17] It is this relationship between transaction costs and economic activity that ultimately determines why different institutional arrangements produce varying levels of market performance. Indeed, the "key feature of markets in a transaction costs perspective is that they are

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9 Claude Ménard & Mary M. Shirley, *Introduction to* THE HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 1, 1 (Claude Ménard & Mary M. Shirley eds., 2005). For example, buyers incur costs in acquiring and processing information to make use of prices; by corollary, sellers incur costs by trying to alleviate the buyer's burden.

10 *Id.*

11 WILLIAMSON, *supra* note 3, at 19. The neoclassical school recognized these costs were important in principle, but neglected to incorporate them because it but lacked a conceptual framework to describe them. *Id.*

12 Menard, *supra* note 4, at 294. A third category is a market-hierarchy "hybrid." *Id.*

13 *Id.* at 293.

14 Ronald H. Coase, Nobel Prize Lecture for Economics (Dec. 9, 1991), *available at* http://www.nobelprize.org/nobel_prizes/economics/laureates/1991/coase-lecture.html.

15 Mary M. Shirley, *Institutions and Development*, *in* THE HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 611, 613 (Claude Ménard & Mary M. Shirley eds., 2005).

16 *Id.*

17 *Id.* at 614.

organized," which means "markets are embedded in institutions that shape them[, and therefore] can take a variety of forms depending on the 'rules of the game.'"[18] So, if economic organization depends on transaction costs, and transaction costs depend on and drive institutional environment, what determines institutional environment?

B. New Institutionalism and Political-Economic Performance

TCE forms the core of NIE: in both, the fundamental unit of analysis is the transaction; all economic activity is conceptualized as contractual; organizational modes are categorized discriminately; and analytic focus is on apportionment of contracting costs.[19] But NIE also goes further than TCE: NIE weaves together the interrelated concepts of transaction costs, social institutions, and political economy into a coherent framework that bridges the gap between the immutable frictionless world of neoclassical orthodoxy and the "real world" of continuous change and uncertainty.[20] This section introduces NIE as "the study of the process of economic change" as a consequence of a constantly shifting landscape of organizations operating within institutional matrices.[21]

"[I]n order to understand and improve economic performance," NIE employs a game-theoretic approach where "[i]nstitutions are the rules of the game," "[o]rganizations are the players," and the ultimate objective is survival.[22] Institutions themselves are divided into two classes: formal rules and informal norms.[23] The sum of these institutions and their enforcement mechanisms embodies the institutional matrix that "defines the opportunity set."[24] In other words, institutional incentive structure (itself determined by transaction costs) defines the parameters of organizational activity, which, in turn, dictate market activity.

Organizations themselves are groups of individuals, united by a common interest, that compete for scarce resources, and are roughly

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18 Ménard, *supra* note 4, at 303–04.

19 WILLIAMSON, *supra* note 3, at 18–21.

20 Douglass C. North, *Institutions and the Performance of Economies Over Time*, *in* THE HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 21, 21 (Claude Ménard & Mary M. Shirley eds., 2005).

21 Ménard & Shirley, *supra* note 9, at 2.

22 North, *supra* note 20, at 22.

23 Ménard & Shirley, *supra* note 9, at 1. Examples of formal institutions include constitutions, laws, contracts, and regulations; informal institutions, on the other hand, structure and inculcate "norms of conduct, beliefs and habits of thought and behavior." *Id.*

24 North, *supra* note 20, at 23.

categorized as either economic or political.[25] While immediate objectives vary depending on organizational category—*e.g.*, profit maximization for economic organizations, and likelihood of reelection for political organizations—the ultimate objective is always the same: survival.[26] Consequently, competition for resources induces organizations to invest in skills and knowledge that they *perceive* to possess the highest anticipated rates of return.[27] Thus, institutional environment determines not only what organizations emerge, but also subsequent organizational activity.

Because the relationship between organizations and institutions is reciprocal, rather than unidirectional, institutional environment is constantly in flux.[28] The key to understanding institutional environment is that the "continuous interaction between institutions and organizations in the economic setting of . . . competition" determines which organizations emerge as well as which organizations survive.[29] Unsurprisingly, organizations seek a competitive advantage by manipulating the institutional environment.

Several organizations competing in advancing self-interested institutional change—or a market for institutional change where purchasers are organizations—produces institutional change that is incremental and path dependent.[30] By corollary, institutions that promote prosperity for long enough are eventually "traditionalized," and those traditions that are best suited for human flourishing progressively displace less prosperous institutions.[31] Institutional

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25 *Id.* at 22. Economic organizations include "firms, trade unions, [and] cooperatives;" political organizations include "political parties, legislatures, [and] regulatory bodies." *Id.*

26 *Id.*

27 *Id.* at 23.

28 *Id.* at 22. "The immediate vehicle by which the actors attempt to shape their environment is by altering the institutional framework in order to improve their (and their organizations') competitive position." *Id.*

29 *Id.* Ergo, transaction costs cannot be immutable.

30 *Id.* at 24. In other words, extant social institutions and organizations are the result of an iterative communal trial and error process. This evolutionary conception of institutions forms the basis of Burkean-Hayekian conservatism. *See, e.g.*, FRIEDRICH A. HAYEK, THE FATAL CONCEIT 18 (1988); FRIEDRICH A. HAYEK, THE POLITICAL ORDER OF A FREE PEOPLE 157 (1979); FRIEDRICH A. HAYEK, THE MIRAGE OF SOCIAL JUSTICE 128 (1976); Edmund Burke, *Reflections on the Revolution in France*, *in* 2 SELECT WORKS OF EDMUND BURKE (1999) (1790); Edmund Burke, *Thoughts and Details on Scarcity*, *in* 4 SELECT WORKS OF EDMUND BURKE 51, 92 (1999) (1795). For a comparison of Burke and Hayek, see Linda C. Raeder, *The Liberalism / Conservatism of Edmund Burke and F. A. Hayek: A Critical Comparison*, 10 HUMANITAS 70 (1997), *available at* http://www.nhinet.org /humsub/raeder.htm.

31 FRIEDRICH A. HAYEK, THE CONSTITUTION OF LIBERTY 54–70 (1960).

matrices thus determine organizational genesis, expiry, and activity during the interim. The central thesis of this evolutionary perspective, as opposed to the hypothesis that institutions are the product of deliberative design, is that a society's oldest traditions encapsulate "superindividual wisdom"—the most successful collective experiences of society's forbearers—and therefore more knowledge than any organization could possibly aggregate in one lifetime.[32]

In sum, societies create institutions to reduce risk and uncertainty in contracting engendered by bounded rationality and imperfect information. Organizations emerge and operate within the existing institutional framework, and try to improve their competitive position partly by deliberately trying to shape the competitive environment to their advantage. Yet, interference by an ordinary organization very likely neglects the extraordinary corpus of knowledge embodied within society's successful institutions. Indeed, the disjunctive tension between self-interest and the common good is recurrent in analysis of political institutional environments: self-interested activity raises transaction costs, which lower overall economic activity, thereby decreasing the communal standard of living.

II
INSTITUTIONAL ENVIRONMENT OF CHINA AND THE UNITED STATES

The initial task of new-institutional analysis is identification of relevant institutions and organizations. Comparative examination of the national policy responses of China and the United States to the financial collapse implicates institutions of governance, economics, and politics. Further circumscription of institutional matrices is country dependent.

The next threshold task is categorization of each institution according to organizational mode, but abstractions such as decentralized and centralized governance structures need some explanation before they can be useful differentiating principles. Friedrich A. Hayek's seminal article *The Use of Knowledge in Society* periphrastically delineates and compares centralized and market organizational modes, and is a microcosm of the broader contest between collectivism and individualism.[33] The rest of Part II is broken

32 *Id.* at 110.

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

down into three sections: section A distinguishes centralized from decentralized organizational modes, and sections B and C synthesize apposite institutional matrices of China and the United States, respectively.

A. Use of Knowledge in Society

Prices communicate supplementary information to actors so they can "fit [their] decisions into the whole pattern of changes of the larger economic system."[34] Hayek's identification of the price mechanism within market organization as a particularly efficient information processor starts with two uncontroversial claims: the most efficient utilization of resources at a particular time and place is unique; and knowledge of those circumstances is distributed among many separate individuals. Consequently, one of the main difficulties in establishing a rational order concerns "the utilization of knowledge not given to anyone in its totality."[35]

1. Organization of Economic Institutions

Taxonomically, there are two classes of arrangements, which overlap with TCE's hierarchy-market distinction: centralized and decentralized.[36] In the context of knowledge utilization, centralized arrangements direct "the whole economic system according to one unified plan" promulgated by a central planning authority.[37] Conversely, in decentralized arrangements, many separate individuals pursuing their own self-interest determine all economic activity. Yet this distinction merely trades one inquiry for another: The evaluative inquiry is which system adapts more quickly to rapid fluctuations "in the particular circumstances of time and place?"[38]

At the outset, centralized arrangements face the formidable task of gathering all "the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess."[39] But knowledge of time and place, alone, is insufficient to allocate all of a society's resources; in addition, the central authority

34 *Id.* at 525.

35 *Id.* at 520.

36 There is also a "half-way house between the two" which delegates "planning to organized industries, or, in other words, monopoly." *Id.* at 521; *see supra* note 12.

37 Hayek, *supra* note 33, at 521.

38 *Id.* at 524. "[E]conomic problems arise always and only in consequence of change." *Id.* at 523; *see supra* note 29.

39 Hayek, *supra* note 33, at 519.

would also need a given system of preferences, as well as "complete knowledge of available means."[40] Only once the central authority concatenated those three variables could it begin to calculate one unified plan to direct the whole of economic activity.

Centralized arrangements are impracticable as a consequence of two incurable flaws. The first concerns size: a national economy has hundreds of millions participants, and each participant has a unique spectrum of knowledge and preference. Assuming a central authority knew what knowledge was needed, the authority would be faced with a choice on how best to collect the knowledge: ask each individual market participant or rely on statistical aggregates? One only need consider difficulties observed in national census taking before selecting statistical aggregation as a matter of necessity. But, aggregation "lump[s] together, as resources of one kind, items which differ as regards location, quality, and other particulars."[41] Indeed, the specificity and granularity of time and place frustrate statistical aggregation, and the alternative individualized polling, is unrealistic. It is thus uncertain how a central planning authority would obtain the knowledge of time and place.

The second incurable flaw of centralized arrangements has to do with the practical consequence of time. Even if the central authority managed to acquire and compute the requisite knowledge, it would only provide a plan for the circumstances of time and place that the knowledge was based on. Such a plan, frozen in time, might theoretically be adequate if the conditions upon which it was based remained fixed. However, the circumstances of time and place are not unchanging; to the contrary, they are fluid and dynamic: "The continuous flow of goods and services is maintained by constant deliberate adjustments, by new dispositions made every day in the light of [the] circumstances" of time and place.[42]

Consequently, a comprehensive economic plan would be outdated before it could ever be complete, let alone disseminated, implemented, and enforced. It is this consequence of temporal impossibility, along with the intractable problem of obtaining adequately detailed knowledge, that frustrates centralized economic planning. As discussed below, the problems of knowledge particularity and temporal impossibility and derivatives thereof, or

40 *Id.*

41 *Id.* at 524.

42 *Id.*

sufficiently rapid adaptation, are principle impediments to centralization in other institutions as well.

The alternative, decentralized, or market organizational modes, leverage the initial dispersal of knowledge and try to determine how much additional information the "man on the spot"[43] needs to fit their "decisions into the whole pattern of changes of the larger economic system."[44] This presents two distinct challenges that routinely frustrate market organization: knowledge dissemination and channeling individual self-interest towards socially desirable outcomes. Indeed, these two challenges are the primary impediments to decentralization, and comparing them with the impediments of integration—knowledge particularity and temporal impossibility—encapsulate the trade-off between integrated and market organizational arrangements. Unlike the intractable challenges associated with centralization, the institutions of market exchange and the price-mechanism solve the challenges inherent to decentralization.

The first challenge of knowledge dissemination actually presents two distinct questions: what information needs to be disseminated, and how is it communicated? The first question can be further reduced to the simpler interrelated inquiries of quantity and quality. In other words, (1) how much knowledge does the individual need; and (2) what is the character of requisite knowledge? The answers lay in the point of view of the decision-maker: he or she is deciding between alternatives, choosing one thing and forsaking another. Accordingly, "[a]ll that is significant . . . is *how much more or less* difficult to procure [those things] have become compared with other things with which he [or she] is also concerned . . . . It is always a question of the relative importance of the particular things with which he [or she] is concerned . . . ."[45]

With the requisite quantity and quality of supplementary information identified, the question becomes how to transmit that information. In practice, prices are abbreviations that communicate precisely the type of information with which individual market participants are concerned: relative difficulty of procurement. The price mechanism is thus a "system of signals which informs us, however imperfectly, of the effects of millions of events which occur

43 "Man on the spot" is defined as a market participant with "limited but intimate knowledge of the facts of his [or her] immediate surroundings." *Id.* at 524–25.

44 *Id.* at 525.

45 *Id.*

in the world, to which we have to adapt ourselves and about which we may have no direct information."[46]

The second challenge for decentralized institutional arrangements, after information dissemination, concerns control—information sufficiency is meaningless if market participants do not subsequently allocate resources amongst themselves. Put differently, there are not enough resources to satisfy every desire of each market participant, and the question is how to reconcile the multitude of contradictory plans. This too is solved by the price mechanism: when a resource becomes scarcer, its price increases; price-increases force market participants to use the resource and its derivatives more sparingly. Competing uses of the resource are reconciled by letting individuals make their own economic decisions, and resources are allocated according to which participant is willing to pay the increased price.

Thus, "using prices as a guide, or as signals," leads individuals "to serve the demands and enlist the powers and capacities of people of whom [they] knew nothing."[47] "The whole acts as one market, not because any of its members survey the whole field, but because their limited individual fields of vision sufficiently overlap so that through many intermediaries the relevant information is communicated to all."[48] However, if decentralized coordination was categorically superior, production firms would not have emerged in a market economy; yet they did. Therefore, there must be some advantage to hierarchical organizational modes in some circumstances.

Production firms are organizations that turn inputs into outputs based on their guiding objectives and technological constraints. Such firms are faced with the "make or buy" decision: whether it is more economical to make, and thereby vertically integrate, a production input rather than it would be to acquire it through the market. "The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism," *viz.*, "discovering what the relevant prices are," or transaction costs.[49] Thus, hierarchy is a substitute for decentralized information asymmetry.

46 Friedrich A. Hayek, *The Moral Imperative of the Market*, *in* THE UNFINISHED AGENDA: ESSAYS ON THE POLITICAL ECONOMY OF GOVERNMENT POLICY IN HONOUR OF ARTHUR SELDON 142, 144 (Martin J. Anderson ed., 1986).

47 *Id.*

48 Hayek, *supra* note 33, at 526.

49 Ronald Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 390 (1937). "[T]he distinguishing mark of the firm is the supersession of the price mechanism." *Id.* at 389.

There are also philosophical justifications for preferring decentralized arrangements to their integrated counterparts. Specifically, central direction inevitably requires the use of coercion; yet, competitive capitalism does not.[50] Instead, organizing the "bulk of economic activity through private enterprise operating in a free market" coordinates the activities of large numbers of people through mutually voluntary exchange.[51] Central economic planning is thus incompatible with individual ordering of economic affairs,[52] and some degree of competitive market exchange is a necessary, yet insufficient, condition to protect individuals from coercion.[53]

2. Organization of Political Institutions

An early extension of the study of organizational affect on economic decision-making was to nonmarket group decision-making, or political activity.[54] Indeed, the potential advantages of centralization are pronounced in politics. For example, political information is often complex, costly to procure, and offers little benefit to those who do acquire it; so, the electorate may economize the acquisition of information by relying on political party ideology to direct their individual voting decisions.[55] Political parties are thus both institution and organization. In the institutional sense, parties emerged to fill a lacuna in political information distribution arising out of governance institutional function. In the more narrow organizational sense, individual political parties aggregate, package, and transmit pertinent information to the electorate.

Political parties are not the only groups negotiating the political-institutional landscape; there are also small coalitions united by common self-interest, or interest groups. What distinguishes political parties from interest groups is their more narrow purpose: interest

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50 *See* 2 FRIEDRICH A. HAYEK, *The Road to Serfdom*, *in* THE COLLECTED WORKS OF F. A. HAYEK (Bruce Caldwell ed., 2007) (1944). In addition to abridging economic freedom, central planning will inevitably metastasize to political freedom.

51 MILTON FRIEDMAN, CAPITALISM AND FREEDOM 4 (1962).

52 The mutual exclusivity of collectivism and individualism is a manifestation of the same "disjunctive tension between self-interest and the common good" mentioned in Part I.B.

53 FRIEDMAN, *supra* note 51, at 10.

54 *Cf.* DANIEL A. FARBER & PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION 7 (1991).

55 Charles K. Rowley, *Public Choice and Constitutional Political Economy*, *in* READINGS IN PUBLIC CHOICE AND CONSTITUTIONAL POLITICAL ECONOMY 1, 6 (Charles K. Rowley & Friedrich Schneider eds., 2008); *see* ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY (1957).

groups pursue legislative instruments that bestow preferential government treatment. The sought after legislative instruments themselves are supplied by "individuals who do not find it cost effective to resist having their wealth taken away. . . . The supply of legislation is, therefore, grounded in the unorganized or relatively less-organized members of society."[56] Notably, what distinguishes those who supply favorable legislation from those that receive its benefits is organizational mode.[57]

Political environment thus approximates a market where legislation is "a good demanded and supplied much as other goods," supplied by society and demanded by interest groups.[58] Yet, unlike the economic environment, there is no automatic price-mechanism to match potential buyers and sellers in the political environment. That role is filled by self-interested politicians and bureaucrats endeavoring to maximize their likelihood of reelection by brokering legislative articles for political groups in exchange for political support in the form of votes, money, and publicity.[59] The central thesis of the economic theory of legislation is that interest "[g]roups compete within the context of rules that translate expenditures on political pressure into political influence and access to political resources."[60]

In the end, preferred organizational mode can vary depending on activity and context. Political institutional environments seem to favor centralized organization: both and political parties and interest groups serve centralizing functions, and emerged to overcome inherent difficulties in decentralized political activity. In a decentralized political arrangement, parties facilitate political activity; likewise, interest groups also facilitate political activity, but more narrowly "to take advantage of rational ignorance within the legislature, through the mechanism of persuasive campaign contributions, to obtain advantages for their members more than commensurate with their

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56 Robert D. Tollison, *Public Choice and Legislation*, 74 VA. L. REV. 339, 343 (1988).

57 Interest group organization is frustrated by free-riders enjoying the benefits derived from successful lobbying without having to contribute. This is why small disciplined groups are the most successful. *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1965).

58 Richard A. Posner, *Economics, Politics, and the Reading of Statutes and the Constitution*, 49 U. CHI. L. REV. 263, 265 (1982). Accordingly, "legislative protection flows to those groups that derive the greatest value from it, regardless of overall social welfare." *Id.*

59 Jonathan R. Macey, *Public Choice: The Theory of the Firm and the Theory of Market Exchange*, 74 CORNELL L. REV. 43, 45–46 (1988).

60 Gary Becker, *Political Behavior*, *in* CAPITALISM AND DEMOCRACY: SCHUMPETER REVISITED 120, 124 (Richard D. Coe & Charles K. Wilbur eds., 1985).

relative voting strength."[61] In a centralized arrangement, notwithstanding interest groups, there is only one political party—accordingly, it is reasonable to expect hierarchies to legislate more coherently and more quickly than their decentralized counterpart. The downside of such expediency is the loss of protection for unpopular minorities. With this economic-political institutional-organizational framework articulated, it is applied to China and the United States.

B. China

A thorny obstacle to setting up the scaffolding of a comprehensive institutional matrix is translating unfamiliar cultural and social norms. An apposite example is the distinction between Chinese and American constitutionalism, *viz.*, the role of a constitution with respect to adherence to the rule of law. Unlike the constitution of the United States, China's constitution is not an ultimate legal authority, but a legitimizing instrument "embod[ying] or expressi[ng] . . . the current policies and thought of the Communist Party."[62] This perspective corresponds with China's volatile constitutional history—including the current 1982 incarnation, China has had four different constitutions.[63] Notwithstanding the lack of legal supremacy, China's constitution outlines institutional structure and organization of the state,[64] and also provides insight into the Communist Party of China, which dominates modern China's governance, society, and economy.

Some of the fundamental differences between Chinese and American institutions are explicated, at least in part, by briefly mentioning watershed historical events. Chronologically, the People's Republic of China (PRC) was founded in 1949 after Mao Zedong and the Communist Party of China (CPC) defeated Chiang Kai-Shek and

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61 Rowley, *supra* note 55, at 14.

62 DANIEL C.K. CHOW, THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA 71 (2003). A second example is that China does not have a separation of powers doctrine like that in the United States.

63 *Id.* at 71–72. Earlier constitutions were adopted in 1954, 1975, and 1978. *Id.* at 72–74. The 1982 constitution was subsequently amended four times 1988, 1993, 1999, and 2004.

64 The preamble to the 1982 constitution formally endorsed "four cardinal principles" that form the political core of Deng's economic theory "socialism with Chinese characteristics." WILLIAM A. JOSEPH, POLITICS IN CHINA: AN INTRODUCTION 156 (2010). The four principles require upholding: (1) the socialist path; (2) the people's democratic dictatorship; (3) the leadership of the CPC; and (4) Marxism-Leninism and Maoism. *Id.*

the Nationalist Party in the Chinese civil war.[65] From 1949 to 1978, China's institutional environment was unequivocally centralized: the state owned all property and directed all enterprise. During most of his lifetime, Mao and the CPC exercised unchecked power over the country. The most notorious example of central economic planning was Mao's "Great Leap Forward" from 1958 to 1961, which centralized rural farming activity and killed 20 to 30 million Chinese citizens by starvation.[66]

In response to the failed practices of the Great Leap Forward, Mao's influence waned as more rational economic policies were required to return China's economic productivity to pre-Great Leap levels.[67] In order to reconsolidate power and destroy his political enemies, Mao followed the Great Leap with a Marxist "Cultural Revolution," which placed the country into perpetual revolution: the judiciary was abolished and a campaign of state-led terror lasted from 1966 until Mao's death ten years later.[68]

Mao was succeeded by the economic reformer Deng Xiaoping, who steered China away from revolution and towards modernization and economic development by implementing "socialism with Chinese characteristics."[69] Deng's theory was codified in the 1982 constitution, which, along with subsequent amendments, evince a tension between the drive towards economic modernization and ideological socialist roots.

The People's Republic of China proclaims itself to be a unitary, socialist, democratic dictatorship under the leadership of the CPC.[70] To maintain the appearance of legitimacy, the "PRC constitution vests power and authority in the political and administrative structures that form the lawful government of China; the exercise of power through these structures is the legitimate exercise of power."[71] However, there is a frequent and pronounced difference between formal organization and reality.

65 The revolution of 1949 is one of "two historic leaps" of China's history. *See* HENRY YUHUAI HE, DICTIONARY OF THE POLITICAL THOUGHT OF THE PEOPLE'S REPUBLIC OF CHINA 238 (2003).

66 CHOW, *supra* note 62, at 15.

67 *Id.* at 16.

68 *Id.* The Cultural Revolution killed or maimed 1,400,000 perceived opponents. *Id.* at 21.

69 Deng's reforms of 1978 are the second "historic leap[]" in Chinese history. HE, *supra* note 65, at 238.

70 XIANFA [CONSTITUTION] Dec. 4, 1982, pmbl. (China).

71 CHOW, *supra* note 62, at 115.

Unpacking the PRC's governance, political, and economic institutions individually provides a much clearer picture of their structure and operation in practice. Broadly, the organization of Chinese governance is centralized.[72] The most obvious example of centralization is the principle of "democratic centrism" set forth in Article three of the 1982 constitution. The tenets of democratic centrism are: "the individual is subordinate to the group, the minority is subordinate to the majority, lower level authorities are subordinate to higher level authorities, and local authorities are subordinate to central level authorities."[73] Thus, all sovereign power resides at the peak of the central unitary state.

In accordance with the principle of democratic centrism, the peak of the state power pyramid according to the constitution—de jure government—is the National People's Congress (NPC), which is China's unicameral national legislature.[74] The NPC consists of several thousand members whose actual influence is somewhat limited, as the real direction comes from the Standing Committee of the NPC. According to the PRC constitution, the Standing Committee is supposed to be the second highest organ of state power, and can exercise almost the same powers as the NPC.[75] Internal organization of the Standing Committee is similarly centralized, and led by a Council of Chairmen, which "[directs] the work of" and "handle[s] the important day-today work of the Standing Committee."[76]

Likewise, subnational government is vertically integrated under the NPC with local people's congresses typically organized at provincial, county, and township levels. In theory, state power is legitimized through the people's congresses, where township and county congresses are elected democratically, and provincial and national congresses being elected by the directly subordinate congress. Republican legitimacy thus appears to be granted by lower level congresses and to flow upward.

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72 *E.g.*, Xiaobo Zhang, *Fiscal Decentralization and Political Centralization in China: Implications for Growth and Inequality*, 34 J. COMP. ECON. 713 (2005).

73 CHOW, *supra* note 62, at 86.

74 XIANFA Dec. 4, 1982 art. 2 (China). The people's congresses are "[t]he organs through which the people exercise state power are the National People's Congress and the local people's congresses at different levels." *Id.* Other constitutional structures are subordinate to the NPC: the Presidency; the State Council, or the administrative arm; the Supreme People's Court and Procuratorate, or the judicial and prosecutorial arms; and the Central Military Commission, which controls the People's Liberation Army ("PLA").

75 *Id.* at art. 67.

76 *Id.* at art. 68.

Structurally, the CPC is analogous to the NPC. Internally, the highest organ of party authority is the national party conference, which is convened approximately every five years. Carrying the NPC analogy further, the Central Committee of the CPC controls important national decisions.[77] However, the most powerful institutions of the CPC are the Politburo and its Standing Committee (PSC).[78] The PSC in particular is China's most senior decision-making body, and its membership is determined by "horse trading among different constituencies, interest groups, and influential retired Party elders, whose interests they represent informally on the PSC."[79] Indeed, the principal intra-party between populists and princelings has evolved into an institution referred to as "one party, two coalitions," which serves as a check on unilateral decision-making.[80]

Subnational organization of the CPC is also analogous to the subnational organization of the NPC. In fact, maintaining parallel structures to the closest degree possible allows the CPC and NPC to fuse at certain critical nodes where the same person occupies key positions in both official government and unofficial party capacities. The result is that the party and government apparatuses are parallel and interlocking, and give the appearance that government and political power are separated.

Yet, as mentioned above, there is a disjunction between de jure and de facto government. Contrary to the legitimate exercise of power according to the 1982 constitution, the "real locus of power"—de facto government—takes place behind-the-scenes. Officially, the CPC is not an organ of state power, but is a political organization subordinate to the PRC constitution.[81] Unofficially, the CPC influences and controls the PRC government by installing top party leaders in leading government positions and by distributing party

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77 The PRC constitution grants the national party conference and the Central Committee almost identical powers.

78 SUSAN V. LAWRENCE & MICHAEL F. MARTIN, CONG. RESEARCH SERV., UNDERSTANDING CHINA'S POLITICAL SYSTEM 4 (May 10, 2012).

79 *Id.* at 3. "PSC decision-making, then, is believed to involve considerable bargaining and maneuvering for factional advantage." *Id.* (footnote omitted). The presence of such bargaining is evidence that the CPC is not ideologically monolithic.

80 Chen Li, *Viewpoint: The Powerful Factions Among China's Rulers*, BRIT. BROAD. CO., Nov. 5, 2012, *available at* http://www.bbc.co.uk/news/world-asia-china-20203937 (last visited Feb 18, 2013).

81 XIANFA Dec. 4, 1982 art. 5 (China) ("No organization or individual may enjoy the privilege of being above the Constitution and the law.").

members throughout the de jure government apparatus.[82] More narrowly, the state and party merge to allow the CPC to exercise power through its control of government organs. In other words, the purpose of de jure governance in PRC is to legitimize de facto governance by the CPC.

In reality, the purpose of the du jure government structure exists to legitimize and shroud de facto governance by the CPC. The CPC is cautious not to usurp the legitimacy of state power because as long as the party's exercise of power is legitimized and ratified by the state, then challenging the CPC amounts to challenging the government and may justify the use of force. Stripped bare, China's legitimization regime is a poorly disguised mechanism of social control.[83]

Perhaps the sole exception to China's preference for centralization is in the economic realm. Notwithstanding constitutional provisions which lodge ownership over the means of production with the public, and call for the "leading [economic] force" to be State Owned Enterprises (SOEs),[84] China has gradually moved towards economic liberalization. For example, agricultural activity was decollectivized, SOEs were freed from strict government control, and private enterprise was permitted.

China's adoption of a hybrid or mixed economy is most clearly signaled by the pronounced growth of private enterprise, especially in rural areas. Accelerating rural modernization is due, in part, to the Township-Village-Enterprise (TVE) paradigm. TVEs are a locational concept, referring to business endeavors, both publically and privately owned, that are physically located outside of cities.[85] Generally, private TVEs were smaller and more productive than their public counterparts. Arguably, TVEs are a Chinese manifestation of

82 For largely historical reasons, the CPC views itself as the destined leader of the PRC. "In the more than 2,000 years of Chinese history . . . no ruling government of mainland China has ever voluntarily relinquished or transferred power to a succeeding government. No succeeding government has ever assumed power without destroying the presiding government." CHOW, *supra* note 62, at 117; *see supra* notes 63–69 and related text.

83 For example, China combines the posts of general secretary of the CPC, the PRC presidency, and the chairman of the CMC into one "paramount leader" in order to maintain control over the PLA. The most notorious example of justifying the use of force to quell dissent occurred in 1989 in Tiananmen Square.

84 XIANFA Dec. 4, 1982 arts. 6–7 (China).

85 YASHENG HUANG, CAPITALISM WITH CHINESE CHARACTERISTICS ENTREPRENEUASHIP AND THE STAFF 77 (2008). The majority of TVEs are private enterprises.

federalism by leveraging information differentials between local and central governments.[86]

The rest of China's economic organization is a hybrid arrangement dubbed market-socialism. According to China's 1982 constitution, ownership of the means of production with the public, and the "leading force" of China's national economy is the driven by state owned enterprises ("SOEs"). China's gradual economic liberalization. Specifically, agricultural activity was decollectivized, state owned enterprises were freed from strict government control, privately owned enterprises were allowed for the first time, and barriers to foreign direct investment were lifted.[87] These reforms, along with increased protection for private property led to China's economic dynamism.[88] China's transition to a mixed economy has been marked by unprecedented economic growth at a rate of 10% per annum for the past thirty years.

One final note about China's relatively underdeveloped legal institutions. The rule of law and protection of private property are prerequisites of a decentralized economic system, yet adherence to the rule of law and private property are still developing within the PRC. For example, the most recent appointment to the highest post of the Supreme People's Court was nominated despite not having any legal training because he was expected to subordinate the constitution to the leadership interest of the CPC.[89] The significance of weak legal institutions is that they inject uncertainty into contracting: people cannot predict what the outcome will be. Thus, Xianfa pays lip service to the rule of law and purports to establish a constitutional democracy, but actually cements the CPC, and especially the PSC, at the head of China's de facto regime.

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86 *Cf.* Barry R. Weingast, *The Performance and Stability of Federalism: An Institutional Perspective*, *in* THE HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 149 (Claude Ménard & Mary M. Shirley eds., 2005).

87 CHOW, *supra* note 62, at 36–37. However, Chinese flirtation with Western ideology doesn't necessarily indicate a shift in CPC orthodoxy; rather, it merely suggests experimentation with alternative organizational modes.

88 HUANG, *supra* note 85, at 55. The "country grew because of private-sector dynamism, a relatively supporting financial environment, and increasing property rights security." *Id.*

89 *See* Jerome A Cohen, *China's Reform Era Legal Odyssey*, FAR E. ECON. REV., Dec. 2008, at 34.

C. The United States

Since its ratification in 1789, the United States Constitution has operated as "the supreme law of the land" in both theory and practice.[90] The organization and operation of its features is the subject of voluminous scholarship, and need not be recounted here.[91] One benefit of such a wealth of scholarship is that it has produced economic models of American institutions of governance and politics. The research program of Constitutional Political Economy (CPE) applies economics to ex ante constitutional decision-making and notably provided an economic justification for constitutionalism.[92]

Complimenting CPE's economic explanation of how constitutional governance structures emerge is the research program of Public Choice. Public Choice "offer[s] a positive theory of how politics works . . . under different sets of postulated rules and institutions."[93] Both CPE and Public Choice consider transaction costs and the economic behavior in non-market decision-making, but at different times. CPE focuses on competitive political activity during pre-constitutional drafting; Public Choice, on the other hand, focuses on post-constitutional political competition. These economic perspectives conveniently frame the U.S. institutional matrix in terms of rational decisions by self-interested actors both before and after constitutional adoption process.

While the American form of government has existed for well over 200 years, it is frequently taken for granted that the founding fathers struggled with how to "combin[e] the requisite stability and energy in government, with the inviolable attention due to liberty and to the republican form."[94] The enduring solution reached by the Framers is the separation of powers doctrine that admitted "national

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90 U.S. CONST. art. VI, cl. 2.

91 *E.g.*, ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA vol. I–IV (James T. Schleifer trans., Eduardo Nolla ed., 2010) (1835).

92 *See, e.g.*, OLSON, *supra* note 57; JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY (1962).

93 Geoffrey Brennan & James M. Buchanan, *The Reason of Rules: Constitutional Political Economy* 94 (1985), *in* 10 THE COLLECTED WORKS OF JAMES M. BUCHANAN (2000).

94 THE FEDERALIST NO. 37, at 181 (James Madison) (George W. Carey & James McClellan eds., 2001). The framers emphasis on stability is consistent with the NIE premise that a chief purpose of (governance) institutions is uncertainty minimization.

representatives may be prone to the influence of 'interests' that are inconsistent with the public welfare."[95]

The two chief interests that worried the Framers—"factions" and "self-love"[96]—both reflect the assumption "that self-interestedness would be the dominant motivating force in human nature often enough so that their failure to embrace the assumption would have disastrous effects on post-constitutional America."[97] In order to avoid becoming "a spectacle[] of turbulence and contention"[98] like previous experiments in democracy, the Framers borrowed the more realistic assumptions of human nature used in economics.[99]

Carrying the economic model one step further, assuming post-constitutional activity was guided by the same rational self-interest that drives economic activity, the Framers concluded they must structure government to channel political self-interest and interest group opportunism towards socially desirable ends:[100] "Ambition must be made to counteract ambition."[101] Broadly, political self-interest manifests itself in the post-constitutional environment as interest groups seeking to appropriate wealth from the society as a whole. Accepting the inescapability of self-interested activity, the Framers knew that the temptation to compel transactions by government coercion would draw actors from the realm of mutually voluntary economic exchange. Accordingly, the constitution was designed to discourage legislative wealth transfers and to steer self-interested activity to the economic sphere.

The channeling objective was accomplished by raising the legislative transaction costs interest groups pay to acquire wealth through government-transfers relative to the costs of consensual market transactions. Mechanistically, the transaction costs of

95 Cass R. Sunstein, *Interest Groups in American Public Law*, 38 STAN. L. REV. 29, 43 (1986).

96 THE FEDERALIST NO. 10, *supra* note 94, at 43 (James Madison). Factions are groups of citizens "united and actuated by some common impulse of passion, or of interest, adverse to the rights of other citizens, or to the permanent and aggregate interests of the community." *Id.*

97 Jonathan R. Macey, *Competing Economic Views of the Constitution*, 56 GEO. WASH. L. REV. 50, 55 (1988).

98 The Federalist NO. 10, *supra* note 94, at 46 (James Madison).

99 In particular, the Framers incorporated the notion that rational self-interested actors engaging in consensual and mutually beneficial transactions can be incentivized to facilitate a common good. *Cf.* IV ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 421 (Edwin Cannan ed., 1904) (1776).

100 Macey, *supra* note 97, at 55–56.

101 THE FEDERALIST NO. 51, *supra* note 94, at 268 (James Madison).

legislation—bicameral approval, enacted by the executive, and *not* invalidated by the judiciary—are intended to channel self-interested behavior away from politics and towards private economic ordering.[102] In short, the separation of powers doctrine protects minorities from oppression by the majority, and protects the majority from depredation by opportunistic minorities.[103] This is the first critical distinction—structural—between China's and the United States' constitutions: Xianfa has no separation of powers principle, but promotes centralization.

Federalism itself serves two important interests: broadly, an expansive and diverse federal republic helps to prevent "a gradual concentration of the several powers in the same department."[104] Further, federalism facilitates experimentation with democracy at the state level, the combination of which with political freedom allows for the expression of, and experimentation with unpopular ideas.[105] Decentralization of federalism also leverages the intrinsic information differential between national and subnational governments.[106] Arguably, China's TVE paradigm is experimentation to realize the benefits conferred by decentralization.

The second critical distinction between China's and the United States constitutions concerns resultant ex post political activity. Unlike China, United States constitution provides for and protects a multiplicity of political parties; yet, for most of the nation's existence, two parties have dominated politics in the United States.[107] In contrast, while China is a one party state, there are two competing coalitions within the CPC. Thus, in both systems, decisions are ultimately the result of two rival alliances within a larger monolithic

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102 *Id.* at 43–45. Likewise, supermajoritarian requirements for constitutional amendment drive transaction costs even higher because the constitutional amendment provides the highest level of legal protection.

103 "The accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few, or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny." THE FEDERALIST NO. 47, *supra* note 92, at 249 (James Madison).

104 THE FEDERALIST NO. 51, *supra* note 94, at 268 (James Madison).

105 *See* JOHN STUART MILL, ON LIBERTY 92–93 (2d ed. 1863) ("Truth, in the great practical concerns of life, is so much a question of the reconciling and combining of opposites . . . to be made by the rough process of a struggle between combatants fighting under hostile banners.").

106 *See* Friedrich A. Hayek, *The Economic Conditions of Interstate Federalism*, *in* INDIVIDUALISM AND ECONOMIC ORDER 255 (Friedrich A. Hayek ed., 1948).

107 The two-party political landscape is a consequence of the chosen electoral apparatus: first-past-the-post plurality. *See* MAURICE DUVERGER, POLITICAL PARTIES: THEIR ORGANIZATION AND ACTIVITY IN THE MODERN STATE bk. 2, ch. 1 (1963).

political order: the difference is that the United States provides greater freedoms of association and speech.

Finally, the third critical distinction relates to legal institutions and adherence to the rule of law. Broadly, "[t]he constitutional function of the [U.S. Supreme] Court is to define values and proclaim principles," but "there is a tension between principle and expediency" in the exercise of judicial review.[108] Accordingly, the Court is the "institution charged with the evolution and application of society's fundamental principles."[109] Specifically, the United States is a common law jurisdiction where the separation of powers principle separates the judiciary from the legislative and executive branches, which consequently provides "more protection against predation by the state and leads to more freedom than code or civil law."[110] Compared to China's lack of independent judiciary, weak property rights, and inconsistent commitment to the rule of law, it is fair to say the greater certainty provided by American legal institutions would endow the United States with an economic advantage.

III
COMPARATIVE EFFICACY OF POLICY RESPONSES

Because American institutions of governance, politics, and economic activity make more complete use of knowledge, everything else being equal, we expect the American institutional response to utilize knowledge more fully, and return to stable economic growth and low unemployment, or at least more quickly than would China's top-down solution. Yet, China's response was more timely, coherent, and effective. The rest of Part III describes (A) each country's policy and (B) evaluates their efficacy.

A. Policies

Both countries passed stimulus plans, which is probative inasmuch as it indicates prevailing macroeconomic policy of each government. Specifically, each country adopted Keynesian stimulus packages, which indicates both China and the United States agreed that expansionary fiscal and monetary policies were the solution to spur

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108 ALEXANDER BICKEL, THE LEAST DANGEROUS BRANCH 68 (2d ed., Yale Univ. Press 1986) (1962).

109 *Id.* at 109.

110 Paul H. Rubin, *Legal Systems as Frameworks for Market Exchanges*, *in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 205, 220 (Claude Ménard & Mary M. Shirley eds., 2005).

domestic demand.[111] This section seeks to highlight the many structural similarities and shared objectives between the two lawful government responses to the financial collapse.

1. China's Response

In November 2008, amid much fanfare, China announced a four trillion RMB stimulus package designed to "further expand domestic demand and assure stable rapid growth."[112] While only two trillion represented previously unplanned stimulatory spending, China's plan was still the third largest proportional expenditure of GDP in world.[113] The details of the Chinese plan were disseminated using party, rather than state, channels, and were promulgated in the form of ten directives enumerated in Central Document Number Eighteen of 2008 (Document 18).[114] Those directives were: (1) acceleration of housing construction; (2) increasing essential services, and acceleration of infrastructure repair in rural areas; (3) expansion of mass transit infrastructure; (4) expansion and a more equal distribution of quality health care and education; (5) conservation of energy, and ecological resources; (6) industrial and technological innovation; (7) accelerate reconstruction of areas damaged by the Sichuan earthquake; (8) increasing income and quality of life in both urban and rural areas, thereby increasing consumption, stimulating the economy, and promoting social harmony and stability; (9) experimental Value Added Tax (VAT) reform; and (10) expansion of available bank credit to promote economic growth.[115]

Organizationally, the majority of the Chinese plan deals with infrastructure investment: directives one through six target specific areas for investment; and directive ten provides funding for the

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111 *See* JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY 129 (Palgrave-Macmillan 2007) (1936) ("If the Treasury were to fill old bottles with banknotes, bury them at suitable depths in disused coalmines which are then filled up to the surface . . . there need be no more unemployment . . . .").

112 Barry Naughton, *Understanding the Chinese Stimulus Package*, 28 CHINA LEADERSHIP MONITOR 1, 2 (2009), *available at* http://media.hoover.org/documents/CLM28BN.pdf.

113 Adam McKissack & Jessica Y. Xu, *Chinese Macroeconomic Management Through the Crisis and Beyond*, ASIAN-PACIFIC ECON. LIT. 43, 47 (2011).

114 Naughton, *supra* note 112, at 2.

115 Liu Zebang, *Document No. 18 of the CPC Central Committee* (Nov. 26, 2008), *available at* http://liuzebang.2000.blog.163.com/blog/static/42248892008102644556842/ (Chinese); *see China Plans 10 Major Steps to Spark Growth as Fiscal, Monetary Policies Ease,* XINHUA NEWS AGENCY (Nov. 9, 2008), *available at* http://news.xinhuanet.com/english/2008-11/09/content_10332422.htm.

stimulus. The remaining directives satisfy related social or political objectives of the CPC: Directive seven deals with the Sichuan earthquake; directive eight addresses long-standing anxiety about wealth inequality between urban and rural China, and directive nine experiments with tax reform. China's plan is remarkably coherent.

Mechanistically, Document 18 communicated to provincial governments what types of projects the central government wanted to fund, thereby initiating a three-step negotiation process similar to the one used under the Chinese planned economy.[116] In step two, provinces responded by submitting a "wish-list"[117] of projects for consideration to the National Development and Reform Commission (NDRC).[118] Finally, NDRC pared the provincial wish-lists down in step three to the proposals that best accomplished the CPC's desired policy goals, authorized those plans, and issued "block-grants" for approved projects.

In total, the central government funded half the approved projects to the tune of 600 billion RMB, and provinces were expected to foot the other half the bill. However, the provinces only had around 300 billion RMB. The solution came from expansionary fiscal policies, increased municipal and corporate bond issuance, and long-term low-interest loans.

2. United States' Response

In frenzied response to the financial collapse, Congress passed several articles of fiscal legislation. In chronological order of enactment, they include the Emergency Economic Stabilization Act (EESA),[119] Tax Extenders and Alternative Minimum Tax Relief Act (TEAMTRA),[120] the American Recovery and Reinvestment Act (ARRA),[121] the Fraud Enforcement and Recovery Act (FERA),[122] The

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116 Naughton, *supra* note 112, at 3.

117 Other than an implicit promise to pay a portion of a project's cost, provinces have nothing to lose by proposing more projects than could be funded. *Id.* Accordingly, the proposed "wish-lists" for the 2008 stimulus plan would have cost over eighty percent of China's annual GDP if fully funded. *Id.* at 3.

118 *Id.* at 2. The NDRC is an agency of the State Council.

119 Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, div. A, 122 Stat. 3765 (2008).

120 Tax Extenders and Alternative Minimum Tax Relief Act, Pub. L. No. 110-343, div. C, 122 Stat. 3861 (2008).

121 American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009), *available at* http://www.gpo.gov/fdsys/pkg/PLAW-111publ5/pdf/PLAW-111publ5.pdf; *see* S. REP. NO. 111-3 (2009), *available at* http://thomas.loc.gov/cgi-bin/cpquery/e?cp111:FLD010:@1(52003).

Helping Families Save Their Homes Act (HFSTH),[123] the Homeless Emergency Assistance and Rapid Transition to Housing Act (HEARTH),[124] and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act (TRUIRJCA).[125]

First, EESA was the statutory framework for the Troubled Asset Relief Program (TARP), meant to remedy liquidity shortages and financial instability. A widely criticized legislative article, TARP's charter authorized the purchase of up to $700 billion of troubled assets[126] with an expected cost to tax payers of $300 billion. TARP acquired troubled assets through a wide variety of different programs,[127] the most reviled of which was the AIG Investments and the Automotive Industry Financing Program, as they represent billion-dollar bailouts of private industry. In more detail, AIG received $85 billion in taxpayer-funded assistance and was transferred to government stewardship.[128] Similarly, the Treasury provided $49.5 billion in assistance to GM.[129]

122 Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, 123 Stat. 1617 (2009), *available at* http://www.gpo.gov/fdsys/pkg/PLAW-111publ21/pdf/PLAW-111publ21.pdf.

123 Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, div. A, 123 Stat.1632 (2009), *available at* http://www.gpo.gov/fdsys/pkg/PLAW-111publ22/pdf/PLAW-111publ22.pdf.

124 Homeless Emergency Assistance and Rapid Transition to Housing Act of 2009, Pub. L. No. 111-22, div. B, 123 Stat. 1663 (2009), *available at* http://www.gpo.gov/fdsys/pkg/PLAW-111publ22/pdf/PLAW-111publ22.pdf.

125 Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (2010), *available at* http://www.gpo.gov/fdsys/pkg/PLAW-111publ312/pdf/PLAW-111publ312.pdf.

126 Troubled assets are defined as "residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability." Emergency Economic Stabilization Act, 12 U.S.C. § 5202(9)(A). More broadly, troubled assets can include "any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress." *Id.* § 5202(9)(B). This amount was later reduced to $475 billion by Dodd-Frank.

127 OFF. OF MGMT. AND BUDGET, FISCAL YEAR 2012 ANALYTICAL PERSPECTIVES 33–37 (2011), *available at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/spec.pdf.

128 *Id.* at 33.

129 *Id.* at 35.

Next, TEAMTRA provided $98.7 billion in tax credits to businesses and the middle class,[130] under the Keynesian theory that providing households with additional income would spur consumption. Four and a half months after TEAMTRA came a sprawling legislative article seen by many as the face of U.S. recovery efforts, the ARRA. Designed to "directly increase aggregate demand,"[131] the ARRA sought to offset reductions in private spending and private investment with government infrastructure investment, thereby stimulating economic activity. The Act itself allocated (1) $282 billion in tax benefits; (2) $274 billion in infrastructure development; and (3) $284 billion in social security programs.[132] After the ARRA came FERA, which merely provided for the establishment of the Financial Crisis Inquiry Commission (FCIC), "to examine the causes, domestic and global, of the current financial and economic crisis in the United States."[133]

Finally, TRUIRJCA, extended tax relief provisions to 2012. Specifically, provisions of both the Economic Growth and Tax Relief Reconciliation Act of 2001,[134] and the Jobs and Growth Tax Relief Reconciliation Act of 2003[135] were extended, in addition to implementing new temporary provisions.[136] Arguably, TRUIRJCA

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130 *See* JOINT CONG. COMM. ON TAXATION, ESTIMATED BUDGET EFFECTS OF THE "TAX EXTENDERS AND ALTERNATIVE MINIMUM TAX RELIEF ACT OF 2008" (Sept. 23, 2008), *available at* http://www.jct.gov/publications.html?func=download&id=1269&chk=1269&no_html=1. TEAMTRA also demonstrates the influence of lobbying groups. *See e.g.*, TEAMTRA, *supra* note 79, at 122 Stat. 3862 § 503 (providing an exemption from excise taxes for "certain wooden arrows designed for use by children"); *id.* at 122 Stat. 3875 § 325 (extending funding to the "wool research fund"); *see also infra* Part IV.

131 Frederic S. Mishkin, *Over the Cliff: From the Subprime to the Global Financial Crisis*, 25 J. ECON. PERSP. 49, 63 (2011).

132 Recovery Accountability and Transparency Board, *The Recovery Act*, http://www.recovery.gov/About/Pages/The_Act.aspx (last visited Nov. 2, 2011); *see* Department of Defense and Full-Year Continuing Appropriations Act, Pub. L. No. 112-10, 125 Stat. 38, div. B, Tit. VII (2011).

133 *See* Fraud Enforcement and Recovery Act, Pub. L. No. 111-21, 123 Stat. 1625 § 5(a) (2009).

134 Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001).

135 Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752 (2003).

136 *See* SENATE COMM. ON FIN., SUMMARY OF THE REID TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION AND JOB CREATION ACT OF 2010 (2010), *available at* http://finance.senate.gov/legislation/download/?id=5598822b-8892-4445-b43a-4da7f0b991a0.

represents supply-side economic thought in ideological opposition to Keynsian spending provisions.[137]

The monetary component to the American stimulus package was executed by the Federal Reserve (the Fed). The Fed consists of a seven-member board of governors, two of which are a chairperson and vice-chairperson, with both leaders and members appointed by the president and confirmed by the Senate for prescribed terms (four and fourteen years respectively). The Fed's "policy decisions do not have to be approved by the President or anyone else in the executive or legislative branches of government."[138] Notably, the centralization of monetary policy in a central government entity suffers from many of the same afflictions of centralized economic policy.[139]

In any event, since the Great Depression of the 1930s, the traditional role played by the Fed in preventing recessions has been the manipulation of interest rates and available credit.[140] Indeed, these two measures are the primary tools for central banks to stimulate or cool their economies. For example, the vigorous slashing of interest rates coupled with monetary expansion credited with ending U.S. recessions in 1981, 1991, and 2001.[141] However, central bank policy measures can lose the ability to generate consumer demand when the market will not "spend enough to use the economy's capacity, even at zero interest rate."[142]

The Fed's response began by lowering the federal funds target rate in late 2007, reaching the current target rate of 0 to 0.25% by the end of 2008.[143] The Fed also loaned $400 billion directly to depository institutions, which had been enough to ease liquidity shortages in the past.[144] However, providing FDIC insured depository institutions with

137 *See, e.g.*, Robert E. Lucas, *Supply Side Economics: An Analytical Review*, 42 OXFORD ECON. PAPERS 293, 314 (2008) (estimating that "eliminating capital income taxation would increase capital stock by about 35 percent"). Of course, there were almost $300 billion in tax credits in the ARRA as well.

138 *Who Owns the Federal Reserve?*, Board of Governors of the Fed. Res. Sys., http://www.federalreserve.gov /faqs/about_14986.htm (last updated Sept. 8, 2011),

139 *See* Kent F. Davis, *The Symbiosis Between Free Banking and Individual Liberty*, 4 MONETARY ECON. EJOURNAL, June 19, 2012, *available at* http://hq.ssrn.com/Journals /IssueProof.cfm?abstractid=2087338&journalid=1508851&issue_number=74&volume=4 &journal_type=CMBO&function=showissue#paper_2087338.

140 PAUL KRUGMAN, THE RETURN OF DEPRESSION ECONOMICS AND THE CRISIS OF 2008 at 173 (2009).

141 *Id.* at 68.

142 *Id.* at 71 (describing a liquidity trap).

143 Mishkin, *supra* note 131, at 59.

144 KRUGMAN, *supra* note 140, at 173.

credit would not alleviate the short-term credit needs of the "shadow" or "parallel" banking system.[145] Ultimately, the Fed was unable to drive down commercial lending rates, despite cutting the federal funds rate to near zero; conventional monetary policies had lost traction on the real economy.

Consequently, unorthodox monetary policies were needed. The Fed responded by expanding its balance sheet by buying large blocks of assets. Liquidity provision and asset purchases are also referred to as quantitative easing. In addition to the easing, the Fed also administered "stress tests" to the nineteen largest finance firms to ensure they had adequate common equity to survive further market deterioration.

The first of these unorthodox policies, liquidity provision, works in the United States the same way it does in China: by increasing the availability of credit. Rather than manipulating bank reserve ratios, the Fed increases lending to banks, historically by lowering the federal funds discount rate.[146] However, conventional means had already failed, and many banks resist direct borrowing from the Fed to avoid giving the appearance of desperation. Consequently, the Fed established the Term Auction Facility (TAF) to facilitate anonymous borrowing at the discount rate.[147] The TAF successfully reduced the liquidity risk premium charged by increasingly strained monetary markets.[148]

Similarly, the Primary Dealer Credit Facility provided liquidity by accepting securities as collateral for loans, disbursing over $8.9 trillion between March 2008 and May 2009.[149] One program stimulated demand for asset backed corporate paper in money market funds, providing the funds with much needed liquidity,[150] while another established a secondary market for money market instruments

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145 *Id.* at 160–61. For a description of the shadow banking system, see *id.* at 158–60.

146 Mishkin, *supra* note 131, at 59–60.

147 *Id.* at 60.

148 JAMES MCANDREWS, ASANI SARKAR & ZHENYU WANG, FEDERAL RESERVE BANK OF NY STAFF REPORTS, THE EFFECT OF THE TERM AUCTION FACILITY ON THE LONDON INTER-BANK OFFERED RATE 1–2 (July 2008), *available at* http://www.newyorkfed.org/research/staff_reports/sr335.pdf.

149 *See* THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE, PRIMARY CREDIT DEALER FACILITY (Apr. 16, 2012), http://www.federalreserve.gov/newsevents/reform_pdcf.htm.

150 *See* THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE, ASSET-BACKED COMMERCIAL PAPER MONEY MARKET MUTUAL FUND LIQUIDITY FACILITY (Feb. 5, 2010), http://www.federalreserve.gov/monetarypolicy/abcpmmmf.htm.

to shore up liquidity vulnerability.[151] Another program allowed financial institutions to borrow Treasury securities on a twenty-eight day term by offering mortgage-backed securities as collateral, thereby providing liquidity to institutions with toxic mortgage assets.[152] The Fed's last lending program provided funding for the purchase of commercial backed paper, thereby improving liquidity in short-term funding markets, and increasing global availability of credit.[153]

In addition to the lending programs, the Fed conducted central bank liquidity swaps, providing foreign banks with U.S. dollar deposits in exchange for deposits in the foreign bank's currency. The impetus for these credit swaps grew out of financial globalization; because investors in one country held substantial positions in another country, cross-border investments acted as "transmission mechanism[s]."[154] Thus, credit line swaps were a necessary artery to infuse the global banking system with liquidity, especially because foreign financial institutions frequently need U.S. dollars. A variety of studies conclude that the Fed's liquidity provision lowered interest rates, improved the performance of dollar swap markets, and reduced interbank risk premiums.[155]

To prevent the massive influx of liquidity from becoming inflationary, the Fed discouraged financial institutions from lending the money by making asset purchases. The purchases effectively resulted in paying banks interest for not lending the recently infused liquidity. Between March and October 2009, the Fed purchased $300 billion of long-term U.S. Treasury bonds in the hopes it would drive up their price, ultimately reducing interest rates charged to consumers.[156]

Next, the Fed purchased $1.25 trillion of mortgage-backed securities between November 2008 and March 2010 for two reasons.[157] First, letting the banks trade their toxic sub-prime

151 THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE, MONEY MARKET INVESTOR FUNDING FACILITY (Feb. 5, 2010), http://www.federalreserve.gov/monetary policy/mmiff.htm.

152 THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE, TERM SECURITIES LENDING FACILITY (Feb. 5, 2010), http://www.federalreserve.gov/monetarypolicy/tslf .htm.

153 THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE, COMMERCIAL PAPER FUNDING FACILITY (Feb. 5, 2010), http://www.federalreserve.gov/monetarypolicy/cpff .htm.

154 KRUGMAN, *supra* note 140, at 177.

155 Mishkin, *supra* note 131, at 60–61 (citing studies).

156 *Id.* at 61.

157 *Id.*

mortgage-backed securities for cash alleviated any liquidity or reserve ratio concerns. Second, the purchase of mortgage-backed securities lowered long-term bond rates and residential mortgage rates, thereby stimulating the demand for housing and its construction.[158] All told, the Fed purchased a total of $1.725 trillion of assets, roughly twelve percent of U.S. fourth quarter 2009 GDP. The asset purchase program is estimated to have pushed long-term interest rates on mortgages down by 52 basis points,[159] "thereby having a substantial effect on residential mortgage rates."[160]

While the influx of liquidity stabilized the financial sector, large financial institutions were relatively low in capital as a consequence of the financial collapse, with the buffer to absorb losses being the hardest hit.[161] In response the Fed developed the Supervisory Capital Assessment Program (SCAP), which began analysis of balance sheets for ability to weather adverse financial conditions.[162] The analysis focused on the nineteen largest financial firms, comparing common equity to vulnerability, and became public mid-2009. This information was well received by markets, with investment pouring into the firms needing it the most, thereby providing the financial sector with an adequate buffer against financial stress.

B. Efficacy

There is a disjunction between expectations and observations: Both China and the United States want to restore stable economic growth; Both want minimal unemployment; both issued stimulus plans. China's institutions are less free and presumably utilize knowledge less fully—therefore, we would expect the U.S. (institutional) response to be more effective. China's response to the fiscal collapse was coordinated and effective. The Unites States' response, on the other hand, was schizophrenic and hyper-partisan. Thus, dissimilar to the emphasis paid to the similarities of plans and their objectives in

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158 *Id.*

159 JOSEPH GAGNON, MATTHEW RASKIN, JULIE REMACHE & BRIAN SACK, FEDERAL RESERVE BANK OF NY, LARGE SCALE ASSET PURCHASES BY THE FEDERAL RESERVE: DID THEY WORK? at 25 (Mar. 2010), *available at* http://www.ny.frb.org/research/staff_reports/sr441.pdf.

160 Mishkin, *supra* note 131, at 61.

161 BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE SUPERVISORY CAPITAL ASSESSMENT PROGRAM: DESIGN AND IMPLEMENTATION 2 (Apr. 24, 2009), http://www.federalreserve.gov/bankinforeg/bcreg20090424a1.pdf.

162 *Id.*

Section A, this section highlights the difference in efficacy between the two superficially similar plans.

1. China's Success

The coherence of the Chinese stimulus plan is particularly well demonstrated by Directive 8's instruction to increase income and quality of life; it promotes the socialist goal of economic equality, thereby promoting social stability. Indeed, GDP per capita increased by an average of 10.64% per year from 2006 to 2010,[163] growing from $2,069.34 (2011 U.S. dollars) to $4,428.46 during the same period.[164] While the per capita share of GDP fell from 7.63×10^{-8} % to 7.47×10^{-8} % from 2006 to 2010, dropping an average of slightly more than half a percent a year,[165] GDP rose an annual average of 11.22% during the period in question.[166] Thus, while an individual worker's piece of the pie was getting smaller, the pie was growing over twenty times faster than the rate that the proportion received was diminishing, and the policy goal of increasing income was being furthered.

While Directive 8 successfully raised per capita income, it was unable to improve the relative income inequality in China[167]; rather, it slowed the rate of decline. Quantitative examination of income inequality or quality of life is impaired by the unavailability of accurate statistics.[168] Consequently, the Gini coefficient,[169] relative

163 THE WORLD BANK, GDP PER CAPITA GROWTH (ANNUAL %) (2011), http://data.worldbank.org/indicator/NY.GDP.PCAP.KD.ZG. Compare to the average annual growth rate in the U.S. of 0±4% during the same period. *Id.*

164 THE WORLD BANK, GDP PER CAPITA (CURRENT US$) (2011), http://data.worldbank.org/indicator/NY.GDP.PCAP.CD. Compare to the U.S., where GDP per capita actually fell by over $1000 in 2009, and in 2010 was only $228 greater than it was in 2008. *Id.*

165 Calculated by dividing GDP per capita, see *id.*, by GDP, see THE WORLD BANK, GDP (CURRENT US$) (2011), http://data.worldbank.org/indicator/NY.GDP.MKTP.CD.

166 THE WORLD BANK, GDP GROWTH (ANNUAL %) (2011), http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG. Compare to the U.S., where the average annual GDP growth fluctuated from -3.5% to 2.7%, averaging 0.82% annual growth, and the per capita share fell an average of 0.86% per year. *See id.*; *supra* note 121.

167 *See* Ming Lu & Hong Gao, *Labour Market Transition, Income Inequality and Economic Growth in China*, 150 INT'L LAB. REV. 101 (2011).

168 *See* Xiaolu Wang & Wing Thye Woo, *The Size and Distribution of Hidden Household Income in China*, 10 ASIAN ECON. PAPERS 1, 1 (2011) ("Official Chinese data on urban household income are seriously flawed because of significant underreporting of income by respondents and non-participation by the high income groups in official household surveys.").

169 The Gini coefficient is a statistical index of income concentration, measuring relative income equality; a high Gini coefficient reflects a high concentration of income.

income gaps, and other calculated measures are used as proxies.[170] As of 2010, a macroeconomist from the NDRC conceded China's income inequality has grown continuously for a decade, and has "exceeded reasonable limits."[171] Because, "the key factor of income inequality comes from income disparity between rural and urban inhabitants,"[172] part of the growing wealth inequality can be explicated by the high rate of urbanization observed in China - 3%.[173] But, considering the NDRC's contention that a Gini coefficient of .47 is dangerously high, and that the Central government was unable to curb the growing income gap, we can infer that the rate of urbanization was insufficient to offset the growing income disparity. Ergo, Directive 8's income equalization objective went unachieved.

Lastly, directive 8 attempted to develop domestic consumption to spur economic growth, thereby reducing Chinese reliance on exports. Again, the unavailability of reliable statistics results in the use of approximations. Officially, the central government claims that domestic retail sales grew 13% in 2008, 17% in 2009, and 18% in 2010; similarly household consumption grew 9 per cent, 10 per cent, and 11 per cent in the same years.[174] A broader and more objective metric, the proportion of international trade relative to Chinese GDP, declined from 71% of China's GDP in 2006, to 55% in 2010.[175]

If the Gini coefficient (G) is growing relative to time (T) such that $\frac{\partial G}{\partial T} > 0$, then income inequality is growing as its concentration is increasing. Therefore, a rising Gini coefficient indicates growing relative income inequality, but does not reflect levels of national or household wealth. Accordingly, it is possible to have a household's absolute position improve, despite a falling relative position.

170 Admittedly, the use of proxies results is a rough approximation at best. *See* JIANDONG CHEN ET AL., BROOKS WORLD POVERTY INSTITUTE, THE TREND OF THE GINI COEFFICIENT OF CHINA, 2 (2010), *available at* http://www.bwpi.manchester.ac.uk /resources/Working-Papers/bwpi-wp-10910.pdf ("[T]he main problem in calculating the Gini coefficient of Chinese residents' income is the shortcomings of the data sources."),

171 *China's Wealth Gap is Approaching Social Tolerance "Red Line*," ECON. INFO. DAILY (China), May 10, 2010 (statement of Chang Xiuze), *available at* http://jjckb .xinhuanet.com/sdbd/2010-05/10/content_220612.htm. More recent reporting suggests that income inequality is still growing. *See Most in China See Growing Income Inequality*, PEW RES. CTR., http://www.pewresearch.org/daily-number/most-in-china-see-growing -income-inequality/ (Oct. 25, 2012).

172 Chen, *supra* note 170, at 2.

173 THE WORLD BANK, URBAN POPULATION GROWTH (Annual %) (2011), http://data .worldbank.org/indicator/SP.URB.GROW.

174 *See* WORLD BANK OFFICE, BEIJING, QUARTERLY UPDATE, 2 fig.2 (April 2011), *available at* http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP /IB/2011/04/29/000356161_20110429003758/Rendered/PDF/614000Replacem1Quarterly 1April12011.pdf [hereinafter CHINA QUARTERLY UPDATE APRIL 2011].

175 THE WORLD BANK, TRADE (% OF GDP) (2011), *available at* http://data.worldbank .org/indicator/NE.TRD.GNFS.ZS. Trade was at its lowest during 2009, at 49%. *Id.*

However, the GDP of China grew 50% during the same period, from 2.2 trillion to 3.2 trillion, and the absolute value of trade during the same period stayed about the same, growing just 129 billion in constant 2000 dollars.[176] In more detail, exports in China fell from 39% of GDP in 2006 (980 billion constant 2000 U.S. dollars) to 30% of GDP in 2010 (1.467 trillion constant 2000 U.S. dollars).[177] Imports fell to a lesser extent, dropping from 31% of GDP in 2006 (732 billion constant U.S. dollars) to 26% of GDP in 2010 (1.084 trillion constant 2000 U.S. dollars).[178] Notably, exports dropped a precipitous eight points in 2009, contributing just 27% to national GDP (1.143 trillion constant 2000 U.S. dollars), falling by 10% that year.[179] In contrast, imports also bottomed out in 2009 at 22% of GDP (903 billion constant 2000 U.S. dollars), but still maintained positive annual growth at an uncharacteristically low 4%.[180]

Notwithstanding the success of the Chinese plan, the growth of domestic retail sales and household consumption have slowed while inflation of the prices of raw commodities has risen.[181] Moreover, "there are increasing signs of excess liquidity," such as speculative investment and an emerging property price bubble.[182] In response, the Central government raised the benchmark interest rate several times, reaching 6.56% in July 2011.[183] Similarly, starting in 2009, the PBoC increased the 17.5% RRR multiple times, settling at 21.5% by mid-

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176 *See id.*; THE WORLD BANK, GDP (CONSTANT 2000 US$) (2011), http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.

177 The World Bank, Exports of Goods and Services (% of GDP) (2011), http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS; The World Bank, Exports of Goods and Services (Constant 2000 US$) (2011), *available at* http://data.worldbank.org/indicator/NE.EXP.GNFS.KD.

178 The World Bank, Imports of Goods and Services (% of GDP) (2011), http://data.worldbank.org/indicator/NE.IMP.GNFS.ZS; The World Bank, Imports of Goods and Services (Constant 2000 US$) (2011), http://data.worldbank.org/indicator/NE.IMP.GNFS.KD.

179 THE WORLD BANK, IMPORTS OF GOODS AND SERVICES (ANNUAL % GROWTH) (2011), http://data.worldbank.org/indicator/NE.EXP .GNFS.KD.ZG.

180 THE WORLD BANK, IMPORTS OF GOODS AND SERVICES (ANNUAL % GROWTH) (2011), http://data.worldbank.org/indicator/NE .IMP.GNFS.KD.ZG.

181 CHINA QUARTERLY UPDATE APRIL 2011, *supra* note 174 at 4, 8.

182 McKissack & Xu, *supra* note 113, at 51.

183 Kevin Yao and Aileen Wang, *China Raises Rates, Shrugs off Slowing Growth*, REUTERS (July 6 2011), *available at* http://www.reuters.com/article/2011/07/06/china-economy-rates-idUSL3E7I61NQ20110706; *China Raises Rates to Counter Inflation*, BLOOMBERG (July 6, 2011), *available at* http://www.bloomberg.com/news/2011-07-06/china-raises-interest-rates-for-third-time-to-curb-accelerating-inflation.html.

2011, thereby sopping up excess liquidity.[184] Consequently, the tightening of monetary and fiscal policies have reduced currency in circulation by almost a fifth in 2011,[185] yet it is unclear whether China has beaten back inflation. To the contrary, despite China's GDP continues growing at around 7.5%, real incomes grew at slower rate, and both GDP and income growth were outpaced by inflation by over 400%.[186]

Nevertheless, China's stimulus plan demonstrated the utility of centralized arrangements: it was a model of inter-government cooperation, efficiency, and timeliness. However, this is not anything new: the principle advantage of centralization is the exercise of control. Based on available information, China's stimulus plan quickly achieved objectives, including stable economic growth, minimized unemployment, and spurred domestic consumption. On the other hand, the lives of most Chinese did not improve with many of the infrastructure projects; instead, their lives got worse. Whether China's stimulus was prudent in in the end will depend in no small measure on whether inflation and income inequality can be controlled.

2. The United States' Disappointment

The FCIC released its report in January 2011, offering half a dozen conclusions, notably including the role inconsistent government policy played in fueling uncertainty and panic in financial markets.[187] This is consistent with the Austrian economic perspective: that the principal cause of financial and economic instability is government interposition with market function. Specifically, if stimulus funds are spent, then the provision of cheap credit results in inefficient investment, which, in turn, drives speculative bubbles.[188] An important caveat: if the cheap credit is hoarded, then there would be no increase in domestic consumption, and therefore no inflation.

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184 *See* Bob Davis & Tom Orlik, *China's Move Shifts Growth to Top of Agenda*, WALL ST. J. (Dec. 1, 2011), *available at* http://online.wsj.com/article/SB1000142405297020401200457706980423264795 4.html.

185 Statistics and Analysis Dept., People's Bank of China, Money Supply (2011), http://www.pbc.gov.cn/publish/html/2011s07.htm.

186 Lingxiao Ou, The Results Are In: Chinese Stimulus Fails, THE FOUNDRY (Aug. 10, 2012), http://blog.heritage.org/2012/08/10/the-results-are-in-chinese-stimulus-fails/.

187 FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT XXI (2011), *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

188 *See* Davis, *supra* note 139, at 10.

Congress estimated TRUIRJCA relieved tax burdens on families and businesses by $857 billion from 2011 to 2020.[189] Likewise, ARRA relieved tax burdens by $300 billion, and was assessed as moderately successful.[190] Unfortunately, outlays to households were largely saved, rather than spent.[191] Outlays to states were similarly windfalls, and spurred consumption in the short-term, but not as much as infrastructure investment would have brought if the expenditures had avoided being whittled away under the continuous political pressure from parties and interest groups.[192]

Notwithstanding high transaction costs, enormous amounts of resources have been consumed in interest group behavior. An example of the costs imposed upon society by such rent-seeking, two thirds of the stimulus spending was earmarked for inefficient use, and the remaining third was cramped and "painfully protracted" in execution.[193] Worse, conservative estimates of taxpayer loss due to TARP come in at $19 billion.[194] Not to mention the likelihood the cheap provision of credit only delayed an economic reckoning; rather than ameliorating the market disruption, the stimulus merely traded it for another bubble in the future. Arguably, we're seeing signs of another bubble already with the return of mega mergers and acquisitions fueled by cheap credit.[195] In the end, the American stimulus plan failed to achieve its objectives: economic growth is anemic, barely keeping rate with inflation, and high unemployment remains.

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189 JOINT CONGRESSIONAL COMMITTEE ON TAXATION, ESTIMATED BUDGET EFFECTS OF THE "TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOBS CREATION ACT OF 2010 at 8 (Dec. 10, 2010), *available at* http://www.jct.gov/publications.html?func=startdown&id=3715.

190 *See, e.g.*, ECONOMIC REPORT OF THE PRESIDENT 19–24 (2011), *available at* http://www.whitehouse.gov/sites/default/files/microsites/2011_erp_full.pdf; PRESIDENT'S COUNCIL OF ECONOMIC ADVISORS, THE ECONOMIC IMPACT OF THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009 SEVENTH QUARTERLY REPORT 5, *available at* http://www.whitehouse.gov/sites/default/files/cea_7th_arra_report.pdf.

191 RICHARD POSNER, THE CRISIS OF CAPITALIST DEMOCRACY 114–15 (2010).

192 *Id.* at 115–16.

193 *Id.* at 115.

194 *See* CONG. BUDGET OFFICE, REPORT ON THE TROUBLED ASSET RELIEF PROGRAM–MARCH 2011 at 2 (2011), *available at* http://www.cbo.gov/ftpdocs/121xx/doc12118/03-29-TARP.pdf.

195 *Cf.* Francesco Guerrera & Dennis K. Berman, *Shopping Spree for Wall Street*, WALL ST. J., Feb. 14, 2013, *available at* http://online.wsj.com/article/SB10001424127887324432004578304541686503434.html.

CONCLUSION AND INFERENCES

One of the factors slowing the American economic recovery is political brinksmanship. The most egregious example is the debt-ceiling debacle of 2011. Starting in the summer of that year, the United States Treasury announced that, unless the debt ceiling was raised, the United States would be unable to satisfy its debtor obligations. There was contentious debate in both houses of Congress about whether or not to raise the debt-ceiling, which was required to make interest payments on the outstanding $14 trillion in debt. What had previously been an un-contentious and non-partisan procedure mutated into sideshow, where extremes of the political spectrum hijacked the national dialogue with a false dichotomy.[196]

In the more abstract phraseology of NIE, the transaction costs associated with American legislative activity have become excessively high. One possible explanation is the terrifying infusion of cash from super PACs—flush with anonymous and corporate donations—is the United States Supreme Court decision in *Citizens United v. Federal Elections Committee*.[197] One part of the majority opinion that is undeniably correct is that money is the medium of political expression. That observation has profound consequences for the function of democracy.

Money can be used to hijack the national political dialogue. In the case of the debt-ceiling debacle, seats in congress have become exponentially more valuable. Interest groups—PACs—are making record expenditures in political support—money in the form of donations. The result is that the high transaction costs appurtenant to the separation of powers are no longer high enough to channel self-interested behavior away from political institutions.

Regardless of whether empirical data exists to test such a bold proposition, it is logically sound. Syllogistically, high transaction costs in the political environment discourage self-interested political activity; the influx of resources in the political environment grew so much that legislative wealth transfers became profitable; therefore, the political environment has succumbed to the whims of interest groups and the interests of government have fallen out of alignment

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196 The crippling partisanship that allows the parties to maintain such uncompromising positions is a consequence of the two-party system, which is itself a consequence of the United States' first-past-the-post electoral system. *See* William H. Riker, *The Two-Party System and Duverger's Law: An Essay on the History of Political Science*, 76 AM. POL. SCI. REV. 753 (1982).

197 558 U.S. 310 (2010).

with the interest of its citizens. As evidence, the same over-hyped brinksmanship occurred once again over the automatic sequestration cuts that were adopted as part of the compromise from the 2011 debt-ceiling debacle.

In sum, China's vertical integration undeniably produced a more efficacious stimulus plan than did the United States' more decentralized governance organization. Indeed, it was the decentralized governance that contributed to relative delay and inefficacy of the American plan. Yet, the trade-off between China's centralization and America's decentralization is not limited to the timeliness and efficacy of policy response to an economic crisis. A corollary of the success of Chinese centralization is its arbitrary and capricious coercion against unpopular individuals and minorities. The PRC is notorious for human rights violations and its intolerance of dissent. The United States, by comparison, has a celebrated tradition of liberty and is one of the freest countries in the world. Arguably, one of the costs of that freedom is a less responsive legislative process, which is still vulnerable to opportunism.