

Use of Litigation and Mediation in China

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We explore the use of litigation and mediation, China's two main channels of dispute resolution, using three decades of province-level legal data from China. Specifically, we examine the importance of economic, legal, and intellectual resources on the occurrence of mediation and litigation, controlling for factors affecting the potential for harms that lead to disputes. We find that all of these measures are important predictors of litigation and mediation claims and that among them, economic resources appear to have the largest impact.

I. Introduction

The interplay between economic and legal development is an interesting area of inquiry, one that has been studied somewhat extensively in developed economies, but less so in emerging economies. China's rapid rise and enormous size make the country an ideal environment in which to investigate this important relationship. Furthermore, an understanding of the forces shaping China's legal trends may prove useful in understanding the evolution of civil disputes in other emerging economies.

For much of the 20th Century, economic and personal activity in China was closely regulated by the Communist Party. With the death of Mao in 1976 and opening of the economy beginning in the mid-1980s, the Party began to devise legislative processes to set out the bounds of legal responsibility for what would be considered unacceptable activity/behavior. An important element of such legislation is the development of civil law.

Legislation on its own, however, is insufficient to appreciate how a community will allocate costs when harms are incurred. Also needed is an understanding of the utilization of dispute resolution systems. This paper aims to identify factors that drive utilization trends and the relative extent of that influence.

To achieve our goal, we do the following. First, we describe the prevailing economic theory regarding dispute resolution as well as empirical evidence outside of China regarding that theory. The result is a set of testable hypotheses. Next, we present information about the data, methods, and analyses used to test our hypotheses. We conclude with a discussion of our findings and suggestions for future research.

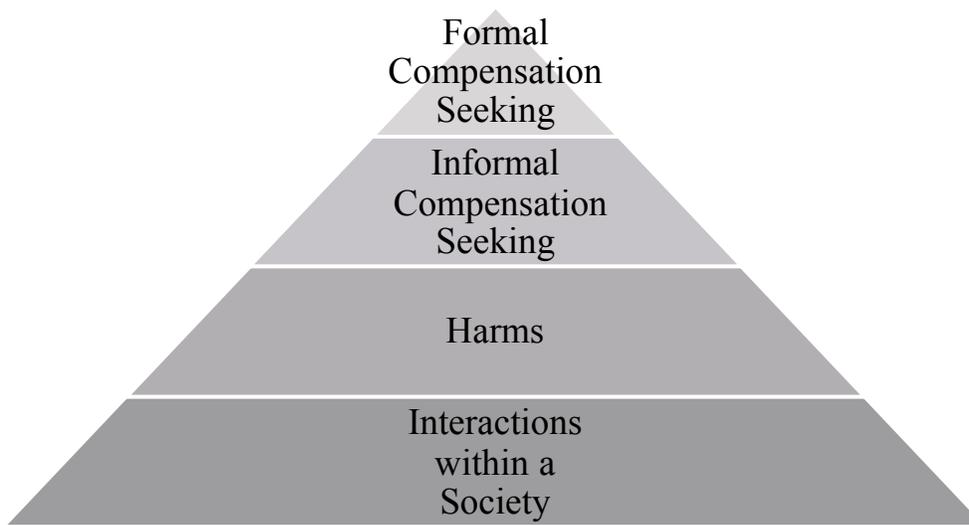
II. Literature Review and Model Development

The individual choice to utilize systems of dispute resolution following harm is one that has interested researchers in numerous fields. A theoretical model of claiming decisions has emerged from this stream of research, generally referred to as the “dispute resolution pyramid.” The dispute resolution pyramid is a conceptual device symbolizing the progression of situations in which disputes may arise (Cooter & Rubinfeld, 1989; Felstiner, Abel, & Sarat, 1980; Miller & Sarat, 1980). The entire process is considered a pyramid because of the decreasing number of situations falling into each step of the process, as shown in Figure 1.

The pyramid begins with social interactions, including precautions taken against the occurrence of harm, and advances through several stages of incurring harm, blaming others for the harm, and seeking compensation from those parties who are blamed. Generally, we assume that parties first seek to resolve disputes informally. When the informal system yields unsatisfactory results, a formal dispute resolution system may be employed.

The dispute resolution pyramid is a useful model to identify relevant decision points throughout the dispute process and the factors that affect decisions at each point, even though the exact shape of the pyramid differs by jurisdiction and dispute type (Miller & Sarat, 1980). By understanding each level in the pyramid and factors that affect each level, we can identify conditions that ought to affect the size of the pyramid tip. That is, we can identify factors that affect how many cases are litigated.

Figure 1: The Dispute Resolution Pyramid



a. Interactions within a Society \Rightarrow Harms

The pyramid foundation represents the potential for harm. This potential generates from interactions among individuals, organizations, and the government. As the frequency of these interactions increases among the entire population, so too does the number of harms, all else equal. Factors that affect the incidence of interactions, therefore, will influence the number of harms in the system. Our first step, then, is to understand the extent of interactions.

A number of studies are informative in identifying relevant factors affecting interactions within a society. One stream focuses on interpersonal interactions associated with urbanization. In urban areas, high levels of interactions arise from the close proximity among individuals. The empirical evidence supports these notions with claiming more common in urban settings (Daniels, 1982; Ellickson, 1991; Bernstein, 1992; Patel et al., 2008; Michaelson, 2007).

Another stream of literature focuses on economic interactions stemming from business relationships, trade, and the structure of economies. The development of economic interactions is thought to increase the potential for harm. Glofcheski (2012), for example, finds support for this explanation in Hong Kong. As Hong Kong's consumer class grew, so did the number of faulty and contaminated product disputes. As a result, litigation rates rose.

An element of economic interactions somewhat unique to China is the country's gradual trend toward privatization. As the share of total assets owned by the general population increases, so too does the potential for disputes over these assets.

We incorporate into our analysis, therefore, measures to represent the frequency of interactions, including **urbanization**, defined as the proportion of the population residing in urban areas and **privatization**, defined as the proportion of assets owned by the private sector. Our hypothesis is that as urbanization and privatization increase, harms will rise and therefore so too will claims for compensation.

b. Harms \Rightarrow Informal Compensation Seeking

When harms occur, claims for compensation may result. Generally, we assume that if an injured party seeks compensation, they first attempt to resolve the dispute informally. In China, People's Mediation Committees are the embodiment of the informal system. These committees operate entirely at the village level and can be used free of charge to resolve any manner of dispute. Though costless

from a monetary perspective,¹ an injured party may reasonably choose not to pursue a mediation claim. Other costs, such as time and effort costs, costs of representation (optional), reputational harm, fear of retaliatory actions, and general discontent, may outweigh expected benefits. Thus, the stage of informal compensation seeking is a smaller set than the initial set of harms incurred.

During mediation, mediators offer guidance and encourage voluntary resolutions between parties. If a mediated resolution is acceptable to all parties, a settlement agreement stating the terms of the resolution may be drawn up and signed. These settlement agreements are legally binding and enforceable and mark an end to the dispute. If a settlement agreement cannot be reached, other channels of dispute resolution such as the court system remain available to the parties (People's Mediation Law²).

It is unclear whether we should expect a positive or negative relationship between the utilization of informal (mediation) and formal (litigation) dispute resolution channels. If informal channels are highly effective in resolving disputes, parties will not require the use of formal channels. In this case, informal channels serve as substitutes to formal channels and a negative relationship is expected. Conversely, if informal channels are not very effective in resolving disputes, parties to unresolved disputes may choose to employ more formal channels. In this case, informal channels may offer some insight into the willingness of parties to seek compensation and a positive relationship is expected.

Regardless of the true nature of the relationship between informal and formal channels, it is clear that the number of cases within the informal environment may be predictive of formal cases. As such, we incorporate the utilization of China's *mediation* system within our analysis China's litigation system through the inclusion of the number of mediation claims per 10,000 people.

Above we also noted that urbanization likely is associated with increasing interactions and hence greater likelihood of harms. In addition to increasing the potential for harm directly, a rise in proportion of individuals living in urban areas decreases the likelihood of knowing the party blamed for the harm. A reduction in personal connection to the blamed party is believed to raise the likelihood of

¹ Mediators in China operate mostly on a voluntary basis; hence, they are not compensated. A few "outstanding" mediators are compensated by the government (see Lee 2014).

² See articles 2, 3, 5, 8, 31, and 32.

claiming. Our measure of urbanization, therefore, also could be representing a measure of personal closeness or distance that could affect willingness to bring forward a claim.

c. Informal Compensation Seeking \Rightarrow Formal Compensation Seeking

If the informal system yields unsatisfactory results, a formal dispute resolution system may be employed. In China as in most jurisdictions, litigation within the court system represents the most formal channel of dispute resolution. Utilization of China's court system requires the filing of a lawsuit. In doing so, plaintiffs are required to file a written complaint which details the legal grounds on which the suit is based, provide evidence and its sources, and identify witness information. If a case is accepted, plaintiffs are subject to court acceptance costs, and if the case proceeds to trial, plaintiffs are subject to trial costs. Thus, use of the court system entails monetary costs that are not part of the mediation system. The non-monetary costs for litigation generate from the same sources as for mediation, yet may be even greater as the process is more public and time consuming.

Given the monetary and non-monetary costs associated with initiating a formal claim, claiming patterns likely relate to the financial, intellectual, and legal resources available to potential claimants. That is, more prosperous individuals, individuals with greater knowledge of dispute resolution systems, and individuals better able to access a lawyers may have a greater ability to pursue a claim, all else equal. As evidence of the importance of financial resources, Ramseyer (2012) finds that conditional on the decision to divorce, individuals living in Japan's wealthier communities are more likely to litigate the terms of the divorce than are individuals in less wealthy communities. In a study of rural Chinese individuals, Mingming and Wangs (2009) uncover a similar result, finding that economic prosperity is positively associated with litigation generally.

The importance of information or knowledge as it relates to claiming is trifold. First, individuals who are knowledgeable about their legal rights may be better able to assess whether a particular harm constitutes a viable claim. Second, faced with the decision to file a lawsuit, an individual with an understanding of the judicial system may be able to gauge the expected costs and benefits associated with litigation more accurately, and may have less uncertainty surrounding these estimates. Third, the expected costs (benefits) to a legally informed individual may be lower (higher) than those to a less informed individual due to their increased ability to navigate stages of the litigation process. Cost reductions may be monetary, in the form of less legal assistance, or non-monetary, in the form of reduced time and effort devoted to the case. Benefit increases are expected to be primarily monetary,

in the form of higher settlement and trial compensation and a higher probability of a successful trial outcome.

A vast body of empirical evidence supports this positive relationship. Ramseyer (2012) examines litigiousness in Japan and finds that conditional on the decision to divorce, individuals that live in better-educated communities are more likely to litigate the terms of the divorce. Eisenberg et al. (2012) and Genn and Beinart (1999) confirm this result in India and England among all types of civil litigation. Mingming and Wang (2009) find that in addition to educational attainment, scores on a test of legal knowledge are positively correlated with an individual's willingness to litigate. In a comparison of individuals who had taken a case to small claims court with those who had not, Vidmar and Schuller (1987) find the same positive relationship between legal awareness and willingness to litigate.

In addition to financial and intellectual resources, evidence suggests that legal resources are important determinants of claim rates. Ginsburg and Hoetker (2006) find that rapidly increasing litigation rates in Japan during the 1990s are largely attributable to an expansion of the Japanese bar, which resulted in greater numbers of lawyers and judges. Carmignani and Giacomelli (2010) confirm this result in a study of litigation rates in Italian provinces from 2000 to 2005. In their analysis, Carmignani and Giacomelli use proximity of a law school in 1975 as an exogenous instrumental variable for lawyer density and conclude that the presence of lawyers is highly predictive of future claims.

Given the theoretical and empirical evidence suggesting a relationship between financial, intellectual, and legal resources with claim rates, we include proxies for these factors within our analysis. **Gross regional product (GRP) per capita** serves as a proxy for financial resources. **Literacy rate**, as measured by the proportion of the population able to read without difficulty, and **Internet penetration**, as measured by the proportion of the population accessing the Internet for at least one hour per week, serve as proxies for intellectual resources. Finally, **lawyers per capita**, as measured by the number of full time lawyers per 10,000 people, serves as a proxy for legal resources. We anticipate a positive relationship between all types of resources and the prevalence of claims.

In addition to these factors, we acknowledge the potential importance of certain characteristics for which we do not currently possess empirical measures. Among these characteristics are the evolving nature of China's civil law doctrine and the influence of the Chinese government, which at times intervenes in the claiming process (Bujakowski, 2016). To combat that possibility of omitted variable bias in our analysis, we include **province and year** effects within our analysis, which are intended to

control for legislative and governmental influence variation, among other things, that differ across space and time.

III. Data, Methods, and Analyses

To test hypotheses developed in the previous section and forecast future claims development, we employ 29 years of province-level data from China (1985-2013). These data are taken from the China Statistical Yearbook Database (CSYD), which includes provincial statistical yearbooks published annually by the National Bureau of Statistics of China. Data include claim counts for mediated and litigated disputes as well as a host of economic and demographic information. Litigation data are derived from law firms and thus represent only those litigated cases which make use of a lawyer.

Table 1 provides a summary of variables hypothesized to influence civil claims, proxies for these variables, definitions of proxies, and the hypothesized direction of influence on claim rates. Three of these variables, GRP per capita, Literacy Rate, and Urban only become available at the province-level beginning in 1988, 1996, and 2004 respectively. Prior to these years, national-level values are available for GRP per capita and Urban but not for literacy rate. To remedy this missing data problem, we impute province-level values using a combination of provincial and national values, when national values are available, and using exclusively provincial values when national values are not available. Specially, in the former case we set imputed values equal to their earliest year provincial value adjusted by national-level value growth rates and in the later case we set values equal to those predicted by a best fit line. Results of our analyses, such as coefficients and R squared values, are largely unchanged when only non-imputed data are employed.

Table 1: Summary of Potentially Influential Factors

Factor	Proxy	Definition	Hypothesized Sign
Financial Resources	GRP per Capita	Gross regional product per capita	+
Intellectual Resources	Literacy Rate	Proportion of the population able to read without difficulty	+
	Internet Penetration	Proportion of the population accessing the Internet for at least one hour per week	+
Legal Resources	Lawyers per Capita	Full time lawyers per 10,000 people	+
Number of Harms	Urbanization	Proportion of the population living in urban areas	+
	Privatization	Proportion of assets owned by the private sector	+
Informal Compensation Seeking	Mediation	Mediation claims per 10,000 people	+/-
Omitted Variable Controls	Province / Year	Province and year effects	+/-

Given that we are working with a panel dataset, we can specify panel data regressions which exploit both cross sectional and time series variation to test the hypotheses outlined in Table 1. Equation 1 provides this general regression framework.

Equation 1

$$Claim\ Rate = f(GRP\ per\ Capita; Literacy\ Rate; Internet\ Penetration; Lawyers\ per\ Capita; Urbanization; Privatization; Mediation; Province\ and\ Year)$$

Where:

- *Claim Rate* refers to the total number of claims filed with law firms or People’s Mediation Committees per 10,000 people per province.
- Other variables are defined as specified in Table 1.

We employ fixed effects to account for heterogeneity among provinces, as we believe it offers several advantages over other commonly used methods of handling heterogeneity such as random effects and first differenced estimation. First differenced estimation is inappropriate for our analysis given the unbalanced nature of our data set. In deciding between fixed and random effects, we utilize

the Hausman specification test, which indicates that fixed effects are preferred. Additionally, recall that the inclusion of any effects likely absorb, at least partially, omitted variables such as legislative and governmental variation. If these omitted variables are correlated with the other regressors, random effects estimates are inconsistent.

Summary statistics are reported in Table 2 and a matrix of pairwise correlations among regressors is presented in Table 3. Table 2 reveals that for all variables, variation within provinces is at least as large as variation between provinces. This result is unsurprising given that our analysis spans almost three decades in which China underwent significant economic and social change. What is more surprising however, is that in many cases, between-province variation is almost as large as within province variation. This result illustrates the vast disparities that exist within Chinese society. Further investigation into these disparities (not shown) suggests that urbanized, coastal provinces seem to be on the high end of the socioeconomic spectrum while more rural, inland provinces are often on the lower end of that spectrum.

Table 2: Summary Statistics

Variable		Mean	Standard Deviation	Minimum	Maximum
Litigation	Overall	6.886	7.119	0.238	46.634
	Between		4.069	2.828	19.419
	Within		5.606	-7.870	39.337
Mediation	Overall	51.724	25.063	11.196	209.177
	Between		16.650	24.419	92.600
	Within		19.741	-15.055	193.720
GRP per Capita	Overall	15439.700	16852.030	560.849	92203.310
	Between		8289.965	4096.759	36402.240
	Within		14743.140	-15488.140	71240.770
Literacy Rate	Overall	0.853	0.097	0.381	0.985
	Between		0.068	0.651	0.936
	Within		0.0706	0.583	1.095
Internet Penetration	Overall	0.117	0.174	0.000	0.752
	Between		0.070	0.024	0.324
	Within		0.164	0.000	0.621
Lawyers per Capita	Overall	1.026	1.392	0.049	10.925
	Between		0.971	0.368	5.120
	Within		0.991	-3.650	6.831
Urbanization	Overall	0.382	0.178	0.010	0.896
	Between		0.131	0.169	0.687
	Within		0.120	0.151	0.710
Privatization	Overall	0.406	0.209	0.033	0.829
	Between		0.067	0.277	0.552
	Within		0.199	-0.045	0.810

Table 3: Pairwise Correlations among Regressors

	GRP per Capita	Literacy Rate	Internet Penetration	Lawyers per Capita	Urbanization	Privatization	Mediation
GRP per Capita	1						
Literacy Rate	0.581	1					
Internet Penetration	0.937	0.563	1				
Lawyers per Capita	0.745	0.388	0.657	1			
Urbanization	0.842	0.688	0.753	0.699	1		
Privatization	0.696	0.600	0.741	0.420	0.567	1	
Mediation	0.184	-0.002	0.219	0.236	0.051	-0.041	1

Results reported in Table 3 are consistent with this description, displaying a high degree of correlation between many of the variables. Provinces with high GRP per capita, for instance, also tend to have high urbanization rates, numbers of lawyers, and Internet penetration, while those with low values for one of these variables tend to have low values across the board. Despite these high correlations among regressors, near multicollinearity among regressors does not seem to be an issue, as standard errors do not appear susceptible to the inclusion or exclusion of regressors.

Table 4 shows the results of our regressions. Results suggest that over 27% of all variation in mediation rates is explained by the regressors (including province, year, and dispute-type coefficients not reported), while nearly 72% of all variation in litigation rates is explained by the regressors (again including province, year, and dispute-type). In examining the coefficients and p-values of individual regressors, we find support for most, but not all of our hypotheses. Specifically, GRP per Capita, Literacy Rate, Internet Penetration, Lawyers per Capita, and Urbanization appear consistent with our hypotheses and statistically significant in the litigation regression, indicating that financial, intellectual, and legal resources are important determinants of litigation claims development, as is the opportunity for harm. On the other hand, Privatization is not statistically different from zero in either regression. Mediation does not appear to be a strong predictor of litigation. This may result from the fact that mediation may at times be a substitute for litigation yielding fewer claims in the mediation system, and other times serve as a proxy of the willingness of parties to seek compensation, which should increase litigation claims.

Table 4: Fixed-Effects Regression

	Mediation	Litigation
GRP per Capita	0.000278 (0.000193)	0.000239*** (0.0000410)
Literacy Rate	24.698 (27.050)	19.317*** (4.403)
Internet Penetration	1.0379 (22.753)	6.581* (3.915)
Lawyers per Capita	0.707 (1.143)	1.738*** (0.204)
Urbanization	3.511 (20.250)	9.571*** (3.161)
Privatization	1.379 (10.264)	-1.256 (1.630)
Mediation	Excluded	0.00712 (0.00760)
Observations	549	695
R2	0.276	0.717

Constant term, province effects, year effects, and dispute-type effects are not shown.

*Significance Levels: *=10% **=5% ***=1%*

A closer inspection of variable coefficients helps to draw additional information which can then be used to distinguish their relative magnitudes. Notably, we find that:

- A 10,000 Yuan increase in GRP is associated with roughly 2.39 additional litigation cases.
- A 1% increase in the proportion of people able to read without difficulty is associated with .193 additional litigation cases.
- A 1% increase in the proportion of people able to access the Internet is associated with 0.066 additional litigation claims per 10,000 people.
- An increase of 1 lawyer per 10,000 people is associated with an increase in litigation claims by 1.74 per 10,000 people.
- A 1% increase in the proportion of people living in cities is associated with 0.096 additional litigation claims.

From this set of results, we consider the relative impact of GRP per Capita, Literacy Rate, Internet Penetration, Lawyers per Capita, and Urbanization on the development of civil litigation claims. One way in which these coefficients can be compared is by determining how rapidly these variables increase in value over time and then normalizing their effect on civil litigation claims by a common time standard. Specifically, we determine each variable's average linear growth rate per year over the 29-year time horizon of this study and then project the one-year increase in civil claims associated with that growth. Using this method, we find that litigation claims grow most quickly as a result of increases in GRP per capita, followed by Literacy Rate, Urbanization, then Lawyers per Capita, and finally Internet Penetration.

IV. Concluding Remarks

As China's economy has grown and expanded over the past thirty years, so too has its legal system. To identify the current set of factors influencing claims development, we employ panel data techniques to determine the marginal effect of various factors on the utilization of litigation and mediation channels. Results support our hypotheses that incidences of potential harm, as well as economic, legal, and intellectual resources are important indicators of claims development. Furthermore, we find that economic resources appear to have the largest effect among these factors.

Future analyses will extend the current research in a number of ways. First, we will employ an extended dataset which includes multiple types of claims and methods of dispute resolution. Second, we will consider more fully the role of legislative reform and government intervention as they relate to claiming. Third, we will begin work on techniques to forecast mediation and litigation claims in the presence of limited data. Our expectation is that the results will be beneficial to any party involved in China's economy, such as business and governmental partners. We further anticipate that the results may be useful to policymakers as they continue to refine the Chinese legal system.

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