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THE CONSTRUCTION OF A LEGAL SYSTEM FOR CHINA'S MARKET ECONOMY[†]

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On November 11, 2002, China, the largest developing country in the world with 1.3 billion people, entered the World Trade Organization ("WTO"). China's entry into the WTO is an extremely significant milestone in Chinese history, particularly with regard to the adoption of reform and liberation policies (*da gaige kaifang*). Entering the WTO symbolizes the beginning of a new era for China; integrating the Chinese economy into the globalization process and substantially accelerating internal reforms. In order to seize the opportunities created by entry into the WTO; meet a variety of challenges; integrate the Chinese economy into the international community through reform, liberalization, adjustment, and innovation; and achieve China's targets for development and modernization, it is critical to harmonize the Chinese legal system with socialist market economy, utilizing the agreements and rules of the WTO. In this way, a fairer legal environment will emerge for actors in both the domestic and foreign markets.

I. CHINA'S PRESENT LEGAL SYSTEM AND THE EMERGING MARKET ECONOMY

Fundamental legal reform in China began in the late 1970s for the purpose of establishing a socialist market economy. More specifically, the planned economy was abandoned to a large extent, and the socialist market system emerged. Reformers have made significant progress towards the constructing a legal system to suit this new economic model over the past twenty years.

A. *Laws Relating to Business Entities*

As with most legal systems for market economies, a company law, a partnership law, and a sole proprietorship law were enacted in China. These laws introduced internationally accepted norms for structuring business entities, managing incorporation capital, and limiting liability.

[†] Due to circumstances beyond the Law Review's control, we are relying on the integrity of the Author for the facts asserted herein that are not supported by a citation.

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The Company Law of the People's Republic of China ("PRC Company Law") provides that a company is a for-profit business entity and that its shareholders undertake limited liability for the debts of the company. By enacting this Law, the old, traditional legislative perception categorizing businesses by their ownership was discarded. Therefore, a new kind of modern corporate legal regime was established. The PRC Company Law includes the following notable provisions: (1) the freedom to establish a business entity; (2) emphasis on the role of capital in the establishment and operation of the entity, and the importance of a company's creditworthiness in safe market transactions; (3) the establishment of corporate governance standards based on check-and-balance principles in which the general meeting of the shareholders is supreme; (4) the promotion of transparency and disclosure of company business practices through the regulation of accounting and financial systems; (5) increased duties for the company's management team; and (6) the protection of the rights and interests of the company's employees. The enactment of the PRC Company Law, the PRC Partnership Law, and the Sole Proprietorship Law has resulted in the protection of the rights and interests of different types of business entities regarding the freedom of establishment, the equality of all businesses, and the independence of management. Therefore, there is now free access to the market for all types of business entities.

B. Construction of a "Right in Rem" for the Legal System

A "right in rem" is the basis for people's daily life and also an important precondition for economic development. A basic "right in rem" was established with the enactment of the General Principles of Civil Law, the Land Administration Law, the Urban Real Estate Administration Law, and the Guarantee Law. These laws show that the PRC no longer rejects the concept of a "right in rem." The laws covering the "right in rem" cover the following three categories: (1) the "right in rem" on ownership (including State ownership, collective ownership, and individual ownership); (2) "right in rem" for usufruct or use (including land use, contracted management rights to land, and the right to mine); and (3) a "right in rem" for security interests (including the right to mortgage, the right of pledge and the right of lien). More importantly, all legal properties, either State-owned, collective, or private (both domestic and foreign) are eligible for legal protection. Ignoring, administratively transferring, and breaching property rights are prohibited. A law on a "right in rem" would entitle Chinese businesses and citizens to property

rights. The great motivating power of the legal system with regard to the “right in rem” is convincingly reflected through the high productivity and increased resources now available. Such things were unthinkable in the past.

C. Improvement of Contract Laws

Contract Law governs transactions and defines and regulates the rights and obligations of parties to an agreement. With regard to the development of the Chinese market economy, there has been significant progress in this area. The enactment of the Economic Contract Law, the Law on Foreign Economic Law, and, most recently, the Unified Contract Law (a combination of the former two laws) is a key example of this phenomenon. The PRC Unified Contract Law is quite “fashionable” because the normal rules for a market economy are reflected in this Law. Furthermore, the Unified Contract Law contains the sophisticated principles, rules, and advancements in foreign contract legislation. Moreover, the Law includes fundamental elements such as the independence of a contractual party’s intent; freedom of contract; principles of equality, willingness, fairness, and integrity; unified and detailed rules, and legal mechanisms for contractual claims. This new contract regime guarantees all businesses complete freedom to do business within authorized areas in whatever form and by whatever means they choose. It also allows for technological innovation and management, optimal efficiency, and overall socio-economic development. In contrast, under the old system, there was no freedom of contract and business activities, and manufacturing and supply were under state control.

D. Legal Standards for Appropriate State Intervention in the Macro-Economy

The market is neither an almighty god nor a pure virgin. Where negative forces endanger fair competition, the state should intervene in the market to protect the interests of the public at large. State intervention into the macro-economy is evidenced by legislation like the People’s Bank Law, the Budget Law, the Audit Law, and the Anti-Unfair Competition Law. All of these laws regulate indirect governmental macro-economic adjustment activities and appropriate interventions for safeguarding the integrity of the socialist market economy.

E. Improvement of the Legal Regime on Social Security

Social security is a requirement for the development of a market economy, and guaranteed social justice, stability, and safety. China established a social security system consisting of labor and public health insurance as early as 1951. Nevertheless, this old security system, with features such as “employer first, and state second,” is not consistent with the new socialist market economy. At present, some pieces of legislation have been enacted, such as Regulations on Collection and Administration of Social Security Funds, Regulations on Unemployment Insurance, and Regulations on Practices of Basic Living Standard for Urban Residents.

The five legal reforms mentioned above represent the basis for the legal system of the socialist market economy. Although much still needs to be done, the basic principles for a market economy are reflected in the above-described reforms. Therefore, we are confident that the existing Chinese legal system is in conformity with the agreements and rules of the WTO.

II. PROSPECTS FOR CHINESE LEGISLATION ON ECONOMIC AFFAIRS

A legal system for a socialist market economy consists of various regulations for the administration of civil and commercial affairs, economic adjustment activities, and social security programs. These are the most important and fundamental kinds of laws, which hold great significance for the prosperity of the state, social development, and the welfare of the people. Although much of this kind of legislation has been enacted in the last twenty years, there is still much to be done. After China’s entry into the WTO, China was obliged to revise its existing legal system and enact new laws to bring the system in line with the common rules of a market economy, fulfill its commitments, and implement WTO rules. Legislative efforts of this kind must be strengthened for the sake of (1) promoting and safeguarding the reform effort; (2) expanding the liberalization of the economy; conducting structural reorganization; and (3) revitalizing science and technology and economic development in order to achieve the four modernizations so that China can become a democratic, highly civilized, and strong nation under the rule of law in the twenty-first century.

A. Enactment of a Civil Code

Civil laws are among the most fundamental laws of any state. The purposes of civil law are to regulate proprietary and personal relationships,

to administer basic social issues, and to protect the rights and interests of the public. China has constructed its modern civil law regime under the General Principles of Civil Law over the past twenty years at an unprecedented rate. For the time being, the most urgent task is to enact a law covering the “right in rem” that is based on existing proprietary laws. The world is approaching an era of science and technology, but a law covering a “right in rem” is still necessary for a country such as China where the economy is undergoing a transition from a planned to a hybrid planned and market economy. Only if there is sound protection for a “right in rem” in place can there be a strong economic system that coexists with diverse business entities dominated by publicly-owned enterprises. Only through the improvement of a “right in rem” can public-ownership be maximized while also preventing problems such as the nominalization of owners, and weakening the incentive to accrue wealth by alienating laborers, business entities, and materials.

A proprietary usufruct right and a proprietary security right should be further exercised in order to establish that the company is a legal entity that owns its own property and that peasants have a contracted right to the management of the land. Also, the structure of ownership must be improved, the quality and competitiveness of the national economy must be reinforced, and the development collective and private economy must be encouraged. It is in this way that property, which may be subject to either public or private ownership, will be lawfully protected and inviolable. It is only when ownership rights are clear, property is protected, and the proprietary relationships are stable that the correct incentives and motivations of billions of people can be created in order to care for the property. Only where people have more wealth, enterprises, and assets does society become rich and the state strong. Therefore, the laws on “right in rem” should be enhanced to create this incentive mechanism. This legal development is a critical element for China's revitalization in the twenty-first century. Once the law on right in rem is enacted, a civil code should also be enacted to: (1) define, detail, and regulate the civil rights, activities, and liabilities of Chinese citizens and legal entities; and (2) consolidate the legal foundation for the Chinese market economy and international economic and trade affairs.

B. The Promotion of Intellectual Property Legislation

Today, with science and technology advancing rapidly, high-tech companies that deal with electronic information and biological technology are developing fast. Technological innovation has become an important

source of economic growth. The question then becomes: how should China face the coming of this new era full of opportunities and challenges? The only option seems to be to complete the unfinished industrialization, while also simultaneously boarding the high-tech express train. Information technology should be used to advance industrialization. These considerations demonstrate that China must strengthen its protection of intellectual property rights under the law in accordance with the WTO General Agreement on Intellectual Property Rights.

Intellectual property rights in science, technology, advanced management experiences, and commercial secrets are invaluable assets that have played a very important role in human history. A new chapter on intellectual property should be included in the civil code, while also updating the current legal regime protecting intellectual property. In October of 2001 the Chinese Patent Law and Trademark Law were revised to comply with WTO rules in the General Agreement for Intellectual Property Rights. The application and scope of the legal protection for intellectual property rights should be extended, and the strength of the protection enhanced in order to ensure the rights and interests of the inventors of new technology. In addition, the freedom of innovation should be recognized and protected under the civil law to motivate new developments in technology. A law on electronic business transactions should be enacted in order to safeguard electronic transactions and prevent breaches of contract and tortuous behavior.

C. Improvement of the Law on Commercial Affairs

Commercial laws are a special type of civil law. The laws on companies, negotiable instruments, insurance, and maritime affairs have been enacted in China. Chinese commercial law must be improved to adapt to the economic developments and significant changes brought about by China's entry into the WTO. To strengthen the internal supervision of state-owned enterprises and support high-tech companies listed on stock exchanges, Articles 67 and 229 of the PRC Company Law were amended in 1999. Specifically, the provisions on the board of supervisors were added. These amendments changed the requirements for: (1) the percentage of technology in the total registered capital of the company; and (2) the issuing of new shares for the first time. In due time, the PRC Company Law should also be amended in the areas of ownership, capitalization, freedom and independence of management, corporate governance, and executive managerial duties. The Insurance Law and the Securities Law should also be improved to bring them more in line with

market economic rules. There must also be an effective supervisory mechanism. A law on reorganization and bankruptcy should be enacted to adapt to increasingly intense market competition and establish a positive market mechanism. Moreover, the Trust Law should be enforced to regulate the disordering trust relationships existing in the markets.

D. Improvement of Economic Laws

Economic laws are important laws for the development of a market economy because there must be appropriate state intervention into the market to promote the best interests of the state and public at large. Laws on Unfair Competition, Protection of Rights and Interests of Consumers, Product Quality, and Advertisement have all been enacted. The most urgent concern at present is to enact an Anti-Monopoly Law in order to protect enterprises' rights to participate freely in the market, and strengthen competitive power and the welfare of consumers. Such an anti-monopoly law should apply to economic and administrative monopolies; domestic monopolistic activities and those foreign activities that impact the domestic market; and domestic enterprises and activities conducted by foreign-funded and wholly owned foreign enterprises. This methodology will ensure a solid legal foundation for fair competition. At present, when foreign investment enters the Chinese market, there must be a clear awareness in order to prevent such investment from monopolizing Chinese markets, controlling the lifeline of the national economy, or damaging national security.

E. Improving Laws for Foreign-funded Enterprises

There are several ways in which the laws governing foreign-funded enterprises should be improved in the future.

- (1) The provisions on the self-balance of foreign exchange revenue and expenditure laws on foreign-funded enterprises and wholly foreign owned enterprises should be deleted.
- (2) Provisions on the preferential treatment for domestic products in the laws on foreign-funded and wholly foreign owned enterprises should be deleted. Procurement falls within the exclusive scope of the enterprise's own management powers. Forcing foreign-funded enterprises to give preference to domestic products is not in accordance with WTO rules. Therefore, these kinds of provisions should be deleted and abolished.

(3) The obligations of foreign funded enterprises with regard to exporting should be deleted. The obligation of exporting is prohibited by WTO rules.

(4) The filing requirements with regard to the business's plan for foreign-funded and wholly foreign owned enterprises should be deleted. These types of provisions are remnants of the old economic system and are inconsistent with both current practice and WTO rules.

Additionally, the state should encourage investment in areas such as agriculture, high-tech industry, basic industry, infrastructure, and environmental protection. The state should also pursue liberalizing reforms in such service industries as banking, insurance, telecommunications, distribution, transportation, legal advisory services and accounting services to improve the capacity for using foreign investment. The methods for using foreign investment must be diverse; therefore, in addition to the existing methods, merger and acquisition, investment funds, and securities should also be used. Multinational corporations must be invited to establish their development and research centers in China to participate in the reorganization of state-owned enterprises. The requirement that the Chinese party to a joint venture have the controlling interest should be abolished, except in those instances where the enterprises relate to state security and economic lifeline. The importation of technology, advanced management experiences, and qualified professionals should be encouraged.

F. Improvement of Foreign Trade Laws

The PRC Foreign Trade Law was enacted in order to implement unified trade policies. However, this Law must be revised and amended on the basis of WTO rules and China's international commitments. Amendments should be made in the following areas: tariffs, quantity and quota restrictions on industrial product imports, the tariffs and quotas for large-scale agricultural products, and restrictions on business licensing for imports. These changes would mean that three years after China's entry into the WTO, all enterprises registered in China may conduct their own foreign trade. Meanwhile, an Anti-Dumping Law, Anti-Subsidiary Law, and Protective Measures Law should be enacted in accordance with WTO rules and agreements.

III. DEVELOPMENT OF ADMINISTRATIVE ENFORCEMENT AND THE JUDICIARY

With China's entry into the WTO, legislation on the market economy will be further strengthened through the revising and enacting of laws. These new and revised laws will reflect the common rules and principles for market economies, and compliance with WTO rules and agreements. The administrative enforcement of law and the judiciary should also be improved to secure the execution of Chinese economic laws.

As far as administrative enforcement is concerned, China has established its own system already. This system includes the following elements: openness for administrative affairs, administrative sanctions, administrative review, and administrative litigation. The methods of administrative enforcement will inevitably be reformed with the introduction of policies on tariff restrictions, elimination of quota and licensing, and transparency requirements. First, indirect macro-economic control should be strengthened. This measure should include making adjustments to the national economy, and leading and directing economic development through policies on industry, taxation, currency, and finance. Second, fair competition practices should be encouraged and maintained. The activities relating to unfair competition, monopoly, dumping, and subsidiaries should be effectively regulated and administered. Protective measures should also be taken to support the domestic industries undergoing serious damages as a result of increasing imports. China must also utilize the mechanism for dispute settlement in the WTO and apply anti-subsidiary measures to Chinese enterprises. Third, China must enhance functional administration in the areas of environment, public health, safe production practices, industry and commerce, and social security. Finally, the state should supervise economic development, particularly with regard to finance. This supervision will prevent financial risk and maintain economic security.

WTO rules require a judicial review mechanism. China has committed itself to the establishment of such a mechanism. Judicial review in this context means that member states of the WTO are required to provide complaining parties with the opportunity to request administrative review and litigation under members' foreign trade laws, administrative regulations, judicial rulings and administrative decisions. China has enacted an administrative review law whereby the complaining party may bring administrative decisions to a high level of the bureaucracy or to court in a litigation proceeding. The issue in this area is that the provisions

on final rulings on administrative decisions should be revised to provide a judicial remedy for all administrative decisions.

In conclusion, China will steadfastly fulfill its commitments to the WTO by revising and enacting laws. Entry into the WTO will be an opportunity to promote the improvement of the Chinese market economy. The economic system for the socialist market economy is full of prospects and vital forces. This phenomenon reflects the progress of the reform era. China will move forward towards its goal of modernization. The prospects at this point are, indeed, bright.