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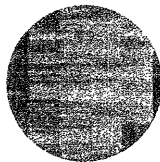
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**FOREIGN INVESTMENT AND LAW  
REFORM IN CHINA:  
A RULE OF LAW, NOT OF MAN:  
SOLUTION OR SAFEGUARD  
IN POST-REVOLUTIONARY CHINA?**

**Richard L. Thurston**

**MITJP 96-25**

Center for International Studies  
Massachusetts Institute of Technology

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**FOREIGN INVESTMENT and LAW REFORM IN CHINA:  
A RULE OF LAW, NOT OF MAN;  
SOLUTION OR SAFEGUARD IN POST-REVOLUTIONARY CHINA?**

by

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**INTRODUCTION**

Proliferation of trade disputes during our lifetime has captured the full attention of the U.S. Congress, the American press and corporate executives alike. Concerns are rooted in perceptions that most developing countries exploit trade barriers to compensate for certain inefficiencies in their domestic economies and competitiveness abroad. Along with the demands for "leveling the playing field" have come outcries for judicial and administrative reforms in countries such as China. Just as critics seek to "westernize" China's economy, so, too, have they argued for pervasive law reform.

While some limited degree of continued "westernization" of China's laws and legal system may be desirable to address the ever changing requirements of a developing market economy, any demands for the restructuring of China's judicial system by extensive transplanting of foreign legal concepts is

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inappropriate and nonresponsive to the fundamental issues in question. U.S. businessmen can obtain some level of assurance that the current trend towards meaningful law reform in China can be validated by Chinese history. Furthermore, that history has shown that foreign investment can be adequately protected once economic stability allows for judicial stability to emerge.

### The End of Communist Ideological Legitimacy

An accelerating decline of centralized national authority coupled with the disintegration of the ideological tutelage of the Chinese Communist Party ("CCP") could ignite a new era of intense political instability and economic chaos for China. Unless a viable alternative to communist party ideological legitimacy is clearly identified and credibly substituted, the PRC may be constrained (perhaps irreparably) from reaching its fullest economic potential. The need to find a workable alternative to the communist solution for achieving "wealth and power" will become all-the-more imperative should the current excesses of unbalanced prosperity and growing individual and economic-oriented crimes continue to challenge the credibility of the central government, thereby usurping the mandate to rule from the leadership of post-Mao China. To what should the CCP turn in addressing this challenge?

The CCP's ascendancy to national power in the late 1940's

depended, in part, on its leaders' abilities successfully to maintain influence over the proletarian masses. While the key tenets of such control were party propaganda, central organization, and the elimination of poverty of the vast majority of the Chinese peoples, the CCP sought to establish a new revolutionary developmental model of a rule of man, resulting in a theoretical egalitarian order.

In proclaiming the new era, the CCP rejected pre-1949 Kuomintang policies for achieving wealth and power. Instead, more dramatic, pragmatic solutions to national hunger, poverty, economic deprivation and foreign domination were offered through Maoist ideological purity (conformity), party leadership (discipline), and implementation of the Chinese variant of communism via administrative and military "guidance."

Through tactics establishing ideologically "correct" relational structures associated with egalitarian mass line politics, Mao's social revolution successfully destroyed, albeit temporarily, many traditional socio-economic structures. But, as Chou Enlai, Deng Xiaoping and others would discover, the effectiveness of an ideology and politics which draws its sustenance from a pure rule of man philosophy must be, of necessity, short-lived. Such ideological orientation, eviscerated by deficient and misplaced economic planning policies and erroneous long-term utopian visions, encountered consistent obstacles to societal betterment, resulting in

successive economic disasters from the mid-fifties through the Cultural Revolution.

Today's China confronts a parlous incubus arising from serious internal contradictions. A highly volatile "Gold Rush" mentality among the Chinese populace within the southern and coastal regions juxtaposed with a deep sense of frustration, if not betrayal, in regions overlooked by the current round of economic development, threaten stability and prospects for sustained prosperity and increased foreign investment.

Hopefully, Deng's succession leadership will realize expediently that a successful, sustained advancement of both economic reform and national development into the 21st Century is increasingly dependent on China's ability to provide its peoples with economic stability, balanced financial gain and comparative commercial freedom. Such economic freedom and prosperity, in turn, are dependent on the regime's success in recalibrating its ideological formula to adopt increasingly a more traditional rule of law, not one of man, and to use the legal system to control the excesses of the new socialism.

The real test will be graded on how well China achieves and maintains the delicate balance between the supremacy of law in commercial/transactional relationships and the general Confucian proclivity to the influence of li (morality-propriety) in socio-political affairs. In so doing, the state may be forced during an interim period to sacrifice certain political "freedoms" common in Western democracies for the sake of

economic development and order. But, such metamorphosis should not impact significantly the status of foreign investment throughout China.

The challenge - of balancing political with commercial relationships - is not new to China. Throughout Chinese history, whenever the rule by men failed to maintain the "mandate of heaven", legal reform was often resorted to in an attempt to preserve or re-establish order.

### The Beginning of a New "Long March"

The highly publicized economic reform campaign of the "Four Modernizations" of the late 1970's and early 1980's delimited the anarchy of the Cultural Revolution and a renewed search by China for wealth and power. This campaign sparked significant Chinese political and academic debate over many issues, most particularly the core of modernization concerns: how to eliminate "judicial" anarchy throughout China (during that era this effort was often referred to as the "fifth" modernization).

Following on the heels of senseless economic disruption and depravity of the Cultural Revolution, post-Mao leadership determined that nascent economic modernization would require the strengthening of the socialist legal system. During the Second Session of the Fifth National People's Congress in July 1979, Hua Guofeng discussed openly the importance of imple-



menting wide-ranging judicial reform:

"Strengthening our socialist democracy and socialist legal system is urgently needed to consolidate the socialist state system...to solidify the political foundation on which the country can carry out socialist modernization in stability and unity, to bring into full play the enthusiasm and initiative of all of our people in modernization..."<sup>2</sup>

He also argued that promulgation of economic-based laws was a pre-requisite to successfully implementing modernization, thus representing a material change in the philosophy of the CCP.

Even though China possesses a significant legal heritage,<sup>3</sup> most commerce and economic-related laws were revoked by the Communist Chinese leadership after their ascension to power. Not only did the CCP attack such laws as being archaic remnants of a decadent KMT rule, Maoist ideology excoriated codified commercial laws as being inappropriate for a society established on egalitarian order.

Emerging from the deprivations of the Cultural Revolution, Hua was concerned that, in a China devoid of such laws, the Chinese government could shun its new constitutional duty to protect the right of its citizens "to own lawfully earned

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<sup>2</sup>FBIS, 10 July 1979, L.3, as quoted in an editorial of the People's Daily, 5 July 1979.

<sup>3</sup>A criminal legal code had been established in China during the T'ang Dynasty (618 A.D. to 907 A.D.). But, a civil code incorporating commercial concepts was not promulgated until the "Republican Era" of KMT rule in pre-1949 China.

income, savings, houses, and other means of livelihood".<sup>4</sup> For China, which bore deep ruts from the wheels of its customs, Hua's statement amplified a perception of a recurring phenomenon in its political history: once a government unresponsive to the people's needs had been overthrown, then long-term stability could be maintained through legal reform.

Contemporaneous with Hua's speech, the government announced that it would draft a civil law in the spirit of the new economic reforms then being discussed. That pronouncement led to widespread debate not only about whether China should adopt such a law, but also as to the appropriate form of law itself. In Democracy and Legal System, for example, Jiang Wei and Yang Dawen queried whether a civil law was compatible with a socialist democracy. Both historical experience and the actual needs of China's developing economy convinced the authors of the validity of their opinion.

It was the "inseparable relationship of civil law with commercial development" which required China's leadership to consider adopting a civil code. After all, Jiang and Yang reckoned, "Marx said that commercial products cannot walk by themselves to the market for exchange."<sup>5</sup> In order to reconstruct and then to modernize its economy, the CCP chose to use

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<sup>4</sup>As set forth in Article 9 of the 1978 Constitution, adopted at the Fifth National People's Congress, 5 March 1978. Printed in Chung-hua Ren-min Gung-he Guo Di Wu Jie Chuan-guo Ren-min Dai-byau Da Hui, Di-yi Tz Hui-yi Wen Jian, Beijing, 1978.

<sup>5</sup>Jiang Wei and Yang Dawen, "We Must Establish a Civil Law," 1 Democracy and Law 18, 1978.

civil law to guide and discipline the proletariat. With that objective in mind, in 1979 the CCP began the first phase of a second long march towards establishing a new society dictated by a rule of law and not of man.

Although 1979 was a very pivotal year in the economic purging of post-liberation communist excesses, the significance of the new legal reform was not lost to the new leadership. Nevertheless, law and its resulting order had to remain subservient, temporarily, to the overriding principles of a Marxist proletarian democracy struggling to find its economic self. Thus, the fundamental purpose for the creation of new laws and their enforcement throughout the early 1980's was twofold: (i) to control all activities which could jeopardize socialist security and disrupt social order; and (ii) secondarily, to provide a basic legal framework within which to attract and to secure foreign trade and investment in the future. Since societal stability was paramount, major emphasis initially was placed on confronting directly excessive influence exerted by party cadres during the Cultural Revolution:

"The cadres at all levels and the party members should become models in observing the law and leaders in executing the state laws. However, certain cadres have a very weak concept of the legal system and some could even be described as lawless."<sup>6</sup>

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<sup>6</sup>Foreign Broadcast Information Service ("FBIS") 11/28/79, p.3, Guangzhou Nanfang Ribao (11/18/79, p.1).

It was incumbent on the CCP and each of its party members to accept both the ideologically and economically strategic importance of a fair judiciary and equitable legal system in protecting the new socialist order. Why? In order to prevent re-emergence of personal abuses and disruptions to modernization, such as the rightist errors attributed to Lin Biao and Chiang Ching, a new legal order would make it more difficult for an individual or group of individuals to manipulate either the masses or the party line for the faux sake of ideological purity. Recent history revealed that:

"As time went on, [the CCP] grew accustomed to our own way of doing things and felt that this was convenient. What a lot of trouble those laws would give us! We began to refer to this or that law. How convenient it was to go without law!...The socialist legal system should have been practiced with intensified efforts long ago..."<sup>7</sup>

Modernization of twentieth century Chinese society has always required the masses, acting through a new, enlightened party leadership, to enact new laws designed to protect more clearly the proletarian democracy by establishing a unified national observance of the same laws. No fundamental difference exists this time around.

Post-Mao leadership sought to establish quickly a new legal structure which could assist effectively in the development of a more economically stable social order, thereby averting further revolutionary or anarchistic upheaval.

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<sup>7</sup>FBIS, 11/28/79, 1.3, Hongqi (11/2/79,, pp, 3-7).

Accordingly, new principles for the socialist legal system were to be adopted throughout China:

- "1. Truly implement the principle that all people are equal before their own laws;
2. The proletariat's judicial organs must maintain independence of judicial procedures;
3. Insist on action according to law;
4. Strictly distinguish between what constitutes a crime and what does not;
5. Oppose the will and intentions of superiors;
6. Laws and systems must have stability, continuity and great authority;
7. Do a good job of building up the courts. Courts at all levels are currently generally under-staffed. There are more cases than can be handled, many court personnel still have other things to do; and
8. Judges must be faithful to the laws and the system, to the people and to the facts." \*

Under this approach, the legal system and the judiciary would serve as arbitrators in readjusting civil and economic relationships amongst the state, the collectives and individuals. In particular, the mission of the new socialist legal system was:

"...protecting the legitimate interests of individual citizens, developing a new type of relations between the people and strengthening unity among the people to serve the four modernizations through the settling of all kinds of disputes over property, rights, benefits, marriage, and family prob

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\*FBIS, L.2, 2/8/79.

lems...to correctly handle contradictions among the peoples, readjust the relations of production not in harmony with the development of productive forces, developing an excellent situation of stability and unity and serving the four modernizations."<sup>9</sup>

Through Hua's vision, the CCP embarked upon an irreversible course to expand the scope of a legal system which would promote/protect the new post-Mao socialist democratic order. In 1979, the justification for law reform did not yet fully lie in economic development and foreign investment. While many of the laws were oriented pragmatically towards satisfying certain Western commercial interests<sup>10</sup>, the ultimate goal remained one of seeking a transitional social foundation for a broader philosophy for achieving national wealth and power. All-the-while, the principal focus centered on avoiding the excesses of the Cultural Revolution so that the masses would never again suffer such economic hardships, deprivations, and, senseless destruction of lives.

The methods of dictatorship allegedly promoted by the "Gang of Four" became the principal target of the reformist party element. Errant policies of certain party members and red guard cadres were attacked because they promoted the

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<sup>9</sup>FBIS, 4/4/79, L.4, from the minutes of the Civil Trial Conference of the Shanghai Municipal Higher People's Court, held on March 17-30, 1979. Similar comments came from all other reporting courts.

<sup>10</sup>Cite examples of several of the key laws such as Joint Venture, tax, foreign exchange legislation, etc.

retrogression of the livelihood and prosperity so eagerly awaited by the masses. By the late 1970's and early 1980's the ills of the Cultural Revolution generated among many a longing for law and order:

"the people [were] craving for law...the people of the whole country [were] eagerly demanding a sound legal system... to effectively guarantee the peoples' democratic rights provided for by the Constitution and constantly develop stability and unity."<sup>11</sup>

To a growing majority of the masses, a return to law and order offered the hope of eliminating terror, restoring stability and providing prosperity to a long-suffering people.

During the subsequent ten years leading to the Tiananmen Incident, references to a rule of law would only occasionally find their way into comments of Deng and others, but never as the driving force for economic reform. But, the eruption of decades of pent-up frustrations during the Tiananmen Incident in June 1979 drove home to certain post-Mao Chinese leadership serious concerns for societal stability during transitional reform and ultimately sparked the development of the second phase of the second long march into the twentieth century.

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<sup>11</sup>FBIS, 7/5/79, 1.9, from Peng Zhen's speech on June 26, 1979, on the Seven Draft laws then being proposed to the Second Session of the Fifth National People's Congress.

## Contemporary Legal Reform Initiatives: A Prologue

Statements on law reform attributable to various CCP officials during the last several years exhibit remarkable similarities to the thoughts and philosophies expressed during 1979. For example, Qiao Shi, Chairman of the Standing Committee of the Eighth National People's Congress, noted that China must "promptly formulate a number of new laws governing the socialist market economy... the NPC must give top priority to the enactment of economic laws."<sup>12</sup> Qiao went on to contend:

"... a market economy requires a sound and comprehensive legal system ... the history of economic development in modern states has proved that without sound legal standards or guarantees, the various social and economic activities will have no guidelines thus inevitably leading to chaos... Chinese laws should be made compatible with international laws and internationally accepted practices to help China's economy to compete globally."<sup>13</sup>

Similarly, Vice Premier Qian Qichen opined that it was necessary to create a clearer legal framework as a prerequisite to lasting economic reform.<sup>14</sup>

In calling for deeper economic reform, PRC President Jiang Zemin has asserted that "the old Administrative means should not be used... cadres at all levels should seriously

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<sup>12</sup> Xinhua General News Service, 2 April 1993, Item No. 0402045

<sup>13</sup> Xinhua General News Service, 1 April 1993; Item No. 0401109.

<sup>14</sup> As reported in The Asian Wall Street Journal Weekly, September 13, 1992 at p.3.



study the basic knowledge and the laws that guide the development of the socialist market economy."<sup>15</sup> Therefore, under the reform agenda, macro-economic control technically equates to prioritizing economic and legal measures over administrative control and guidance.

Before more closely examining the elements of contemporary legal reform being discussed and any relationship it may have with the proposed new economic order, some of the historical roots of "rule of law" in early twentieth century China should be examined. Within those glimpses into the past a new insight into the role of legal reform in China can be gleaned, which history will help to establish a more proper perspective on present reform initiatives.

### Historical Roots in Twentieth Century China

Historically, China has fluctuated between a rule by custom and moral example (rule of man) and control by regulations and punishment (rule of law). Throughout the millennium prior to 1949, China evolved a highly refined legal system based on a strictly defined interrelationship of li (customary morality-propriety) and fa (punishment). The li formed the basis of societal rules and education while the fa was often a tool for its implementation. However, when the li failed to

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<sup>15</sup> Xinhua General News Service, 14 May 1993, Item No. 0514155.

maintain an acceptable level of people's livelihood, legal reform employing fa, to one degree or another, provided a remedy.

Travelling back into a recent historical era - the late nineteenth and early twentieth centuries - we discover that the new economic relationships then being established throughout China posed the most serious threat to Chinese sovereignty and stability. Expanded trade with western nations barraged China with western commercial law concepts which were much more complicated than those with which Chinese merchants had become familiar, for example: bankruptcy, agency, brokerage, carriage, bills of lading, etc. Rights and obligations increasingly became less governed by interaction among closely related groups of kinship than by individualistic, impersonal mercantile relationships.

Those new relationships were not singularly disruptive of Chinese society. However, when combined with increasing decentralization of government authority and the erosion of administrative control, the societal fabric of China unravelled rapidly to the extent that early twentieth century Chinese society teetered on the brink of partition by foreign powers, civil war and revolution. Incessant warfare subsequently erupted throughout much of rural China during a period commonly referred to as the "Warlord Era".

In the early twentieth century certain Chinese literati and politicians recognized the urgency of enacting pervasive

political and judicial reforms to preserve Chinese society. Proliferation of the foreign presence on Chinese territory and the growth, let alone the increasing complexity of commercial transactions, required an internationalization and unification of China's laws and judiciary, including a greater emphasis on the "rule of law" for commercial affairs and relationships. Accordingly, a new era of legal reform blossomed in China. Institution of both a rule of law as well as the principles of "Science and Democracy" offered solutions to China's ills.

Consequently, from 1904 to 1929 successive Chinese law revision commissions investigated, digested and analyzed then-contemporary Western and Japanese laws. They simultaneously collected and summarized thousands of disparate customary laws in force throughout China. Early twentieth century law reform was two-fold in character: new courts were created throughout the country, followed by the enactment of substantive and procedural codes. As to the newly established judiciary, the reformists determined that China would respond adequately to modernization pressures only if the new courts were able to achieve independence from the dominant political part(ies) and politicians. Furthermore, the judiciary would have to implement a unified interpretation of new laws and enforce them on a national basis.

Although most Chinese geographic regions which were subjected to incessant warlord incursions or foreign treaty rights succumbed to judicial anarchy, where conditions permit-

ted, such as in the coastal regions, a rule by law was effectuated and increasingly brought new stability and order to those regions. New law schools opened their doors, graduating young, albeit often idealistic, lawyers and judges, such as the venerable John C. H. Wu of Shanghai. They did not idolize law but often believed that it offered a viable vehicle by which China's most serious problems could be addressed and by which the East and West could meet; potentially resulting not only in the stability and territorial integrity of China, but also in world peace and prosperity.

As a testament to the success of legal reform, litigation rose significantly as the populace became increasingly convinced of the judicial fairness and equity of civil and criminal decisions of the nearly 200 reform courts, including the Ta Li Yuan (Supreme Court). For example, from 1914 to 1921, cases submitted to the District Courts as Courts of First Instance increased thirty-three percent from 28,414 to 37,784 annually.<sup>16</sup> Out of Antung (Liaoning), the American Vice-Consul reported that:

"the general effect of these [District and High] Courts is very good. The judges are seemingly of a progressive tendency and their decisions viewed in light of Western precedents, usually fair and equitable..."<sup>17</sup>

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<sup>16</sup>Summarized from "Shen-p'an Ya-men Pieh-shou-chieh Ti-i-shen An-chien Pi-chiao Tuao" found in Chung-hua Min-kuo Min-shih T'ung-chi Nien-pao.

<sup>17</sup>U.S. Department of State, National Archives, general serial files, File #893.041/13. D.B. Lasseter to the Secretary of State, October 26, 1921.

In many cases, court decisions, especially those of the Ta Li Yuan, predated comparable decisions by U.S. courts. Many cases dealt with issues between Chinese and foreign parties successfully. That is not to say that corruption did not occur or that law reform was not without its errors. It did and was. However, the new judiciary marked a significant improvement over the conditions existing during the last years of the Qing dynasty.

In the Fall of 1925, many foreign residents of China anticipated apprehensively the forthcoming visit of an International Commission on Extraterritoriality.<sup>18</sup> After investigating China's judicial system the Commission would submit to the Western Powers, Japan and China recommendations on the future status of extraterritoriality. Predictably, reports and criticisms of "native" judicial barbarity invaded China's foreign language press as justification for retention of extraterritorial privileges.

Several of the articles were penned by Rodney Gilbert, a vituperate spokesman of the pro-extraterritorial rights movement. He argued that new laws and procedures could not alter Chinese moral standards. "They will simply be new devices behind which a more shameless sport can be made of justice and its administration." An investigation by Western jurists and statesmen was unnecessary, he contended. Instead,

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<sup>18</sup> In 1921, the Washington Naval Conference authorized a Commission composed of international jurists, statesmen and businessmen to investigate China's judicial system and laws.

"China should be told firmly and frankly that the evidence against her fitness to govern her own people and to administer justice is so overwhelming that it is an insult to the intelligence of the occidental people..."<sup>19</sup>

During the 1920's, many foreigners in China unjustifiably shared Gilbert's view of a primitive and inefficacious Chinese judiciary. They linked Chinese law and its reform to Western concepts of order and political legitimation. In particular, a western-style constitution was deemed by Western critics to be a prerequisite to creating a solid foundation for laws which were to be enacted by a legislature. But, the Western concept of law and order was alien to the Orient. Instead, order, then law was more often the cultural norm.

As events unfurled in 1925, it looked as if the Commission would never have an opportunity to undertake its investigation. The second Chihli-Fengtien War in late 1924 forced the postponement of the scheduled visit. Other confrontations also plagued China in late 1924 - early 1925 resulting in additional delays: a second Kiangsu-Chekiang War was fought during the winter of 1924 - 1925; Fengtien forces took Shanghai and; Feng Yu-hsiang's forces consolidated their position in Hunan and Honan. On May 30, 1925 British Police

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<sup>19</sup> Rodney Gilbert, "The Extraterritoriality Question - A Case for Businessmen not Jurists," The North-China Herald and Supreme Court and Consular Gazette (NCH), November 7, 1925, p. 271.

killed thirteen demonstrators on Nanking Road in Shanghai.<sup>20</sup>

Despite the unstable environment, in October 1925 the Ministry of Justice sent to the Western Powers formal invitations to attend in China a December 12th convening of the International Commission. On January 12, 1926, after several delays, the International Commission on Extraterritoriality held its first session in Peking.<sup>21</sup> From January through April, the Commission received and reviewed translations of China's laws, draft codes and reports on court organization prepared by Chang Yao-tseng's Extraterritorial Commission. Occasionally during this period, the delegates would visit a local prison or court as they did on February 1st when they visited the Supreme Court, Chihli High Court and a Peking prison. Another visit scheduled for February 2nd was canceled when court officials and employees of the Ministry of Justice went on a nine-day strike in protest of the delinquent payment of wages.<sup>22</sup>

The Commissioners were impressed by the "beautifully

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<sup>20</sup> Other disturbances were reported in Hankow and Shamen in Canton.

<sup>21</sup> Delegates from thirteen nations participated on Commission which simultaneously investigated China's judicial order and discussed tariff rates. Silas Strawn of the United States was selected Chairman and Wang Chung-hui, honorary President. D/S File #793.003C73/241 and 793.003C73/257, Silas Strawn to the Secretary of State, January 11, 1926 and January 21, 1926, respectively.

<sup>22</sup> D/S File #793.003C73/279,280. Strawn to Secretary of State, March 1, 1926 and March 12, 1926, respectively.

printed laws" but believed them to be meaningless because of the overly generalized perceived inability of the courts to enforce them. Most distressing was the conclusion reached by Commissioner Silas Strawn that the major weakness of the laws, whether promulgated or not, lay in the fact that China lacked a Constitution which would provide a legal basis for the laws.<sup>23</sup> This and similar attitudes reveals a flaw in the Commission study - an underlying belief that in order for laws to be enforceable, they must both gain their legitimacy from a Constitution and be mandated by a Western-style legislature. Little did Strawn understand that the Chinese judiciary, one of the oldest in the world, had survived centuries without a Constitutional basis. What was needed in China to insure justice was not a Constitution but order and a government capable of promoting that order. We should not lose track of that prerequisite today!

Not all people familiar with the Chinese reform efforts were oblivious to the problems which would materialize further as China attempted to adopt and assimilate occidental laws. Dr. Stanley K. Hornbeck, for example, recognized that judicial reform sought -

"to produce in and for China a body of laws which will meet with the approval of all of the important treaty powers....The inevitable result...will be that the codes contain many provisions which are

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<sup>23</sup> Ibid.



not an outgrowth of Chinese thought and experience, which are inconsistent with Chinese conceptions, and which will run counter to traditional Chinese habits and practices. If China's new laws satisfy the foreigners, will they be suited to the Chinese? If they are suited to the Chinese, will they satisfy the foreigners? Can there be produced a system of law which, both as to regulations and administration, can be applied equally, with justice and with satisfaction, to the Chinese and nationals of some twenty powers who reside, travel and do business in China?<sup>24</sup>"

The answer to his last question was and remains "yes"! The solution, however, required (then and now) both domestic stability and foreign patience which would allow China to effectuate and to perfect a level of judicial reform which acquires legitimacy from Chinese customs and traditions, not solely Western politico-judicial concepts. It was equally important for Western nationals resident in and doing business in China to discard their ethnocentrism and cultural imperialism.

The Commission had originally planned to stay only one or two months in Peking in order to make preliminary investigation into, and analysis of, the written laws. The remaining time would be spent touring the provinces in order to examine the actual conditions of the judiciary. Because of civil warfare, the Commission, on several occasions, postponed its

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<sup>24</sup> W. R. Fishel, The End of Extraterritoriality in China (Berkeley: University of California Press, 1952) pp. 111-112.

plans for the traveling committee to make the tour.<sup>25</sup>

Finally, on May 10th, conditions had improved enough so as to allow the traveling committee to tour several of the Northern provinces. The tour's itinerary took the committee 4,200 miles, to seven High Courts, thirteen District Courts, one Branch District Court and two special courts, the latter located at Harbin.<sup>26</sup> On June 16th, after a grueling trip, the Commissioners returned to Peking. Six days later, the traveling committee submitted its report to the full Commission.

In every place visited by the travelling committee, magistrates no longer exercised judicial functions.<sup>27</sup> Consequently, the magistrate's treatment of parties and judicial issues could not be observed. As to the reform courts visited, the committee was favorably impressed:

"From information supplied to the committee in answer to their questions, confirmed as far as possible by personal observation, the conduct of cases in modern courts appears such as to give parties, including accused persons in criminal cases, an opportunity of being fully heard. The judges and the procurators seem to be intelligent and experienced men, familiar with law and procedure applied in the courts, and to give the cases

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<sup>25</sup> The Report of the Commission on Extraterritoriality in China, 1926, p. 149. (Hereinafter, RCE).

<sup>26</sup> Ibid., pp.149-156. "Report of the Traveling Committee of the Extraterritoriality Commission", May 10-June 16, 1926.

<sup>27</sup> Ibid., p. 151.

before them their most careful consideration...The organization of the courts visited and the procedure followed therein showed considerable uniformity, and appeared to be in accordance with law and regulations on the subject, which were studied by the entire commission at Peking. The records of the courts appeared to be kept in a very satisfactory manner, without, however, adequate facilities for protection against loss by fire or theft, especially in the cases of documents relating to title of land. The court buildings and general equipment were satisfactory, and in a few instances eminently so."<sup>28</sup>

Reports received by the Committee before embarking on the journey confirmed those observations.

After receiving the traveling committee's report, the entire Commission began a slow process of drafting a final report.<sup>29</sup> Heated arguments over the content erupted. Nevertheless, on September 16, 1926 a final report, consisting of four parts, was submitted.<sup>30</sup> Wang Chung-hui, China's Minister of Justice, disagreed vehemently with much of the analysis. Although he affixed his signature to the final report, he reserved China's approval of the first three

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<sup>28</sup> Ibid., pp. 151-152.

<sup>29</sup> That the Traveling Committee Report had any bearing on the final analysis is doubtful. Strawn, in his April 16th report to Secretary of State Kellogg, had already submitted his tentative recommendations and proposals. D/S File #793.003C73/297.

<sup>30</sup> Part I discussed the historical evolution and contemporary status of extraterritoriality in China. Part II summarized China's laws and judiciary. Part III discussed in some detail, primarily from a political point of view, the administration or justice in China. Part IV consists of the Commission's recommendations.

sections.<sup>31</sup>

Of all the Commission's observations and conclusions, the most favorable to China was the Commission's criticism of extraterritorial rights and privileges. Although extraterritoriality had been designed to protect foreign interests in China, the Commission noted that because of the multiplicity and diversity of the foreign courts, the lack of judicial training of the diplomatic consulars, extension of jurisdiction over Chinese Nationals and the inviolability of foreign property, the routine functioning of China's judiciary had been seriously impaired.<sup>32</sup> In spite of this conclusion, the Commission could not recommend the immediate relinquishment of extraterritorial rights and privileges. Only after the Chinese Government had succeeded in implementing fully the Commission's other recommendations would the Powers "be warranted in relinquishing their respective rights of extraterritoriality."<sup>33</sup> Even then, the choice remained that of the Powers to make.<sup>34</sup>

Commission criticisms of judicial reform focused on the instability of the political environment and their belief

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<sup>31</sup> RCE, p. 109. "By signing this report my approval of all the statements contained in Parts I, II, and III is not to be implied."

<sup>32</sup> Ibid.

<sup>33</sup> Ibid., Part IV, p. 107.

<sup>34</sup> Ibid., p. 108.

that a foreigner could not receive a "fair" hearing from a Chinese court. The Commission could neither accept the absence of a constitutional base nor approve of the Peking Government's failure to separate the legislative, administrative and judicial powers of its officials.<sup>35</sup> It was not that China's laws failed to provide for formal separation of powers, they did, but that supposedly the absence of a controlling central government permitted military interference. Nevertheless, only one example of such interference was cited by the Commission: the arrest and summary execution of the Chief Justice of the Shantung High Court.<sup>36</sup> Because of such so-called "incessant" military interference, the Commission concluded that a uniform application of laws was non-existent.<sup>37</sup>

Centuries-old philosophy and customs, the Commission argued, also contributed to the non-uniform application of laws, and thus the likelihood that the foreign litigant would not receive a judicious hearing by Chinese courts. The Commission determined that heavy emphasis on mediation and, quite ironically, case precedence, were incompatible with the

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<sup>35</sup> Ibid., p. 51.

<sup>36</sup> Ibid., pp. 92-97.

<sup>37</sup> Ibid., pp. 97-98.

requirements of twentieth century China.<sup>38</sup> Even the Supreme Court's interpretations and decisions were reportedly applied inconsistently from one province to another. But, were these facts so undesirable or indicative of an archaic judiciary to justify the continuation of extraterritoriality? Hardly not. China, in fact, was in the process of developing a well-reasoned, common-law tradition which was not so inflexible as to require the dissimilar provinces or districts to apply one civil law without any deviation. Foreigners could, and did receive judicious treatment under such conditions.

On this point, the German experience in Shantung after World War I established that foreign nationals could receive a fair hearing in Chinese courts. Arising out of a 1921 Sino-German Agreement, German nationals resident in China were guaranteed a right to trial in the reform courts. They were also entitled to be represented by German counsel, interpreters and enjoyed appeal as of right. J. J. Heeren, writing in the China Weekly Review, noted that the Germans received very good treatment by the Chinese courts whose decisions were of "a generally high order." He did not report any case of "serious miscarriage of justice."<sup>39</sup> In business disagreements the Germans adapted quite successfully to the Chinese

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<sup>38</sup> Quite ironic, especially when one considers that the underlying principle of Anglo-American law was and remains, precedence.

<sup>39</sup> Fishel, Extraterritoriality, p. 270.

practice of commercial arbitration, "using their Chambers of Commerce as courts of adjustment between their members instead of going to court."<sup>40</sup>

The Commission also remarked about the flaws and inconsistencies in laws already promulgated. The Code of Civil Procedure, for example, referred to provisions and definitions in a civil code as of then unpromulgated. But the Commissioners failed to realize that the Draft Civil Code had been applied by the Courts largely as if it had been mandated legislatively. Overlooked also was an important reason behind the failure to draft a civil code: many of the Western based provisions and Chinese customs written into the first draft were incompatible with China's 1920's attempt to develop its society. In fact, Chinese such as John C. H. Wu and American lawyers resident in China of the like N. F. Allman criticized China's adoption of a codified law, believing that China should have pursued more steadfastly the course of common-law.<sup>41</sup>

Due to these and other conditions, the Commission noted that a foreign national could not receive justice from Chinese courts. The errors referred to by the Commission often were procedural and not substantive. Procedural deficiencies,

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<sup>40</sup> Ibid.

<sup>41</sup> NCH, N. F. Allman, "Present Day Chinese Law and Courts", October 17, 1925 and John C. H. Wu, private interviews held in May 1976.

however are to be expected in any new judicial system, especially one which is inexperienced and unfamiliar with new laws. Nevertheless, procedural deficiencies should not be condoned and, in fact, seldom would they be approved by China's appellate courts. The decisions of the Supreme Court, for example, do not indicate any prejudice or injustice to a foreigner because of his nationality.

In some degree of fairness to the Commission, conditions in China during the 1920's were not conducive to the uniform and consistent application of laws. Many foreign attitudes were understandable and often justified. How else could an alien resident feel but seriously endangered when, for example, during the summer of 1925 serious anti-foreign protests riots and attacks upon foreign persons and property erupted in the Yangtze Valley, during which judicial authorities were powerless to intervene.<sup>42</sup> Numerous reports of torture and maltreatment of Chinese prisoners in the interior could not go unnoticed. But, these matters were not the result of a barbaric judicial order but of anarchic conditions in certain areas of China.

Similarly, the laws which were promulgated by the KMT were of sufficient completeness and clarity so as to rank them with the most modern continental European and Japanese codes. Substantive legal reform encompassed the writing of three

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<sup>42</sup> RCE, P. 97.



drafts of a Civil Code and its promulgation during 1929 - 1930; new procedural laws were enacted and special laws on copyrights, bankruptcy, negotiable instruments, corporations, etc. were promulgated to facilitate trade, most especially with the foreigners. By 1930, China possessed a new set of laws and regulations which represented a fairly well-balanced, modern synthesis of Western and Chinese laws and customs. Many of those laws were emulated by the CCP during the Kiangsi Soviet era (early 1930's) and also exist today on Taiwan.

The general success of law reform during this period debunks the myths that Chinese are a non-litigious people, as Confucianist lore would suggest. Unlike the Japanese who have a far greater tendency to avoid open and disruptive confrontation, the Chinese are more naturally litigation prone. It was through various customs that Confucian traditions discouraged and suppressed this nature as magistrates and the bureaucracy became increasingly unwilling or unable to address legal concerns in an equitable and judicious manner. But, just as the Chinese instincts for commerce and self-preservation negate substantive support for communism, the population will openly support law reform if they can be convinced that law and the judiciary can be safeguarded from corruption and inequities.

**BUILDING A NEW SOCIALIST MARKET ECONOMIC STRUCTURE**

The fundamental issues in the search for wealth and power encountered by the Qing, then by the KMT of pre-1949 China, and subsequently by the KMT on Taiwan, while different in scale and intensity, remain relatively the same in substance to those very issues at the core of Chinese development today:

- (i) How can China best grapple with the issues and problems associated with foreign influence, investment, new economic structures, pressures and trends, and matters arguably unique to the Chinese peoples?
- (ii) Can China decentralize economic authority, while maintaining a balanced economic development and social equities in the distribution of wealth and prosperity?
- (iii) To accomplish the above goals, which approach is more appropriate, a rule of law or an egalitarian society based on the rule of man?

There is not and never has been any simple solution to those issues. But, as expectations and frustrations of the masses rise, as social order disintegrates in both rural and metropolitan China, and as increasingly violent personal and economic-oriented crime pervades all corners of society, once again China teeters on instability and possibly anarchy.

History, however, has furnished China with a rich juri-

dicial heritage which may provide some answers if not a solution to some of those ills. When properly analyzed and understood, that heritage can offer to the new generation of reformers a legal endowment both relevant to twenty-first century China and which can help to satisfy Deng's goal of "building socialism with Chinese characteristics."

Conscious of the challenges confronting China, Deng has set in motion a pioneering undertaking to pull off major economic restructuring in the form of a socialist market economy. Deng seeks to build a new socialist "spiritual" civilization with Chinese characteristics, which social order would close the gap between the rich and the poor while opening China wider to the outside world.<sup>43</sup> Essential to the new order would be a re-engineered people's "democracy" in which science and technology would be the primary productive forces.<sup>44</sup>

One cornerstone of the ideological foundation for this new order and modernization of China is an earlier announced concept (circa 1980) of "mutually reliant relationships." Of the several mutually reliant relationships identified by Deng, most relevant to China today is the relationship among

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<sup>43</sup> cite fbis - li peng speech on 4/1/93 ----

<sup>44</sup>as identified in a speech by Deng on march 31, 1993 and reenforced by Li Peng in a major speech the following day. See, ...

economics, politics and law.<sup>45</sup> The proper recognition and handling of such relationships will allow for the unity of internal contradictions, the streamlining of government, and the minimization of bureaucratic interference in economic development.

Reflective of the significance ascribed to the economic reform effort, Tong Dalin, one of China's chief economic architects, is fond of quoting an old Chinese saying:

"The spring wind suddenly comes one night,  
and pear flowers blossom on tens of thousands  
of trees."

To Tong, the new socialist market economic system exalted by Deng represents the blossoming of many pear flowers simultaneously. Although this blossoming in the filtered moonlight of new found prosperity is beautiful to behold, will the harvest bear any edible fruit?

To ensure the successful conversion to a socialist market economy, China's leaders are turning to the enactment of economic laws and the establishment of a comprehensive and sound legal system. A new legal order will provide the people and government leaders with a more transparent and meaningful degree of legal guidance, standards, guarantees and restraints. The success of this effort will rely, to a certain

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<sup>45</sup>See speech of Deng in 1980.

degree, on foreign example and experience, particularly important if China is to succeed in continuing to improve the investment environment and in protecting the legitimate investment rights and interests of foreign businesses operating in China.

Why does the socialist market economy of China need a sound legal system? As China moves from a centralized economy (which relied primarily on administrative means for economic management, but easily susceptible to manipulation by individuals) to a free market-oriented environment where the market dictates economic development, new laws and legal structures are required in order to prevent economic chaos and to protect fair competition. Thus, the objective of the new legal order is to promote the institutionalization and enshrinement of democracy and a free and open socialist market economy in the laws of China.<sup>46</sup>

In the eyes of Qiao Shih, "having laws is better than having no laws at all."<sup>47</sup> To him and others, legal reform is a prerequisite to the institutionalization of a socialist democracy because only through it can one promote political unity and stability without jeopardizing economic development. While much of what is said is politically correct jargon, nevertheless, it signifies a much more fundamental effort to

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<sup>46</sup>See Qiao Shih speech of April 1, 1993.

<sup>47</sup>See Qiao Shih's speech at ....

hold together a nation of great diversity and conflicting priorities: the new legal reform is being structured to eliminate arbitrary political intervention during this new phase of the development of a market economy.

Several tactics to accomplish the goals of legal reform must be adopted: (i) according to Qiao Shih, the old economic laws, such as the law on joint ventures first promulgated in 1979, are the remnants, "shadows", of a planned economy and economic intervention; therefore those shadows must be eliminated; (ii) according to Jiang Zemin, China's previous political leaders lacked experience in adequately understanding the importance and nature of laws, thereby committing innumerable leftist mistakes, therefore, those mistakes must be rectified and new understandings reached; and (iii) China can no longer afford to become an international pariah, or else it will be by-passed by international economic developments. A key impediment to China's international participation in the immediate past has been the state of its legal system, or lack thereof. Therefore, its legal system must be compatible with the world order, necessitating judicial reform to comprehend the legal and legislative experiences of not only China but also those of foreign countries as well.

To achieve the goals of legal reform, first, the government must focus on several categories of law reform: (a) establishing norms to guide the economic conduct of primary

commercial organizations/bodies, such as corporations; (b) establishing norms to guide market activities and to maintain economic order, such as new laws governing securities, negotiable instruments, fair competition, etc.; (c) establishing norms governing macroscopic economic regulation by the state, such as those governing currency, foreign exchange and financial transactions, banks, etc); (d) protecting science and technology through laws and regulations promoting and protecting intellectual property; and (e) establishing criminal norms for those who jeopardize the security, unity and stability of the socialist market economy. Out of those laws, a new foundation can be established which will have a significant impact on the nature of socio-political relationships generally. Within the next five years, at the latest, the preliminary legal framework establishing the new legal order must be established if China is to avoid the instability which lies on the horizon."

#### CONCLUSION

Uncontrolled growth of a "Gold-rush" mentality throughout much of China has exacerbated the traditional problems associated with Chinese "guanxi" (relations building among men) and, as a result, such materialism has eroded signifi-

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"See the speech dated 3/31/93 ...

cantly the central core of CCP legitimacy. It is easy to understand why, then, the heart of the new reform effort should emanate an energy which will revive a "spiritual" civilization through the creation of a more clearly defined legal order, which order will "punish corruption and promote a diligent and clean administration in a serious manner."<sup>49</sup>

A more impersonal law is once again the most appropriate vehicle with which to control economic relationships rather than having business development solely dictated by political considerations. In this way, Chinese leadership can more properly align economic development with certain historical tenets which have proven successful in addressing similar goals and objectives throughout the prior millennium. To the Chinese people, who ascribe significantly more value to commercial freedom and prosperity than to their political freedom, there does exist a material difference between a rule of law which can promote economic equity through a system of defined checks and balances and a rule of man which permits, if not encourages, ubiquitous abuse and rampant corruption in a Chinese environment where custom inevitably tends to encourage personal excesses and abuses as the populace competes for limited wealth and power.

For the ancient Chinese culture which has witnessed

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<sup>49</sup>See the Government Work Report given by Premier Li Peng on April 1, 1993 .....



customs and human relationships become firmly entrenched in the fabric of that society, reform, to be meaningful and lasting, requires a change in the direction of tutelage provided by the state. The more susceptible a people are to a rule of man, the more imperative it becomes that, somewhere along the reform continuum, there is established a more rational counterbalancing and equitable rule of law so as to solidify order and opportunity in the search for wealth and power. The excesses and abuses of communist rule make the realization of that rule of law all the more urgent.

Once the orientation of the political tutelage of the CCP can be recalibrated through a rule of law, then the excesses and abuses of communist rule, especially those lingering from the Cultural Revolution and the Tiananmen Incident, can be addressed more naturally. Issues and concerns for such abuses, especially in the area of "human rights" can and should be better left to more subtle reform efforts once the new legal order is established. For now, pressures on the Chinese government would be better served if focused, in part, on encouraging Deng and others aggressively to continue down the path which seeks to establish decisively a rule of law and not of man. After all, how better to address human concerns than to promote the establishment of a fair and equitable judiciary which will enforce constitutional and other legal rights. Recent history, of the 1910's - 1930's, reveals that such a

reform movement is highly possible to maintain. The link with past abuses and excesses can be broken with creative thinking and an appreciation of the true nature and motivation behind China's onward search for wealth and power.

China's leadership must be encouraged and then allowed to shed themselves of the baggage of their recent past. Along the way, international efforts should be focused on the establishment in China of a new relational model for sustaining order, and then cleanly overcoming the hurdles encountered prior to 1949 in providing prosperity for the many and not the few. Otherwise, China will find itself stumbling down a path far more treacherous than that encountered in the CIS today. As revealed in the recent successes of Taiwanese and Singaporean economic development, law can and must enable China to harness its productive forces in such a manner that allows wealth and prosperity to be achieved and spread more uniformly throughout China. Then, once the market economy takes root, law reform and the rule of law could become an end unto itself and take the paternalistic socialist democracy down a path unintended by Deng, but not necessarily incompatible with Chinese history.

Legal reform is also a prerequisite for providing a degree of stability to an investment environment which may otherwise experience significant socio-political nationalistic transition, as is emerging throughout the rest of the Asia-

Pacific region. We are facing an era which requires great fluidity in policy thinking but without causing foreign companies to withdraw those investments which help to provide the opportunity for a more peaceful transition.

So long as a rule of law can continue to materialize unimpeded in China then any degree of military posturing of the PLA against Taiwan, Hong Kong, or other economies will not have the deleterious effect which it would otherwise have in extremely unnavigable waters. The challenge to the U.S. and our companies is to maintain a firm but consistently fair position on trade and investment-related issues without alienating the Chinese by what they may view as a "scorched earth" policy of trade sanctions or forced, unnatural change.

In part, it is incumbent for U.S. policy makers to develop a new, creative approach to Chinese relations which fully comprehends the analogies to be drawn from Chinese history. Similarly, we need to abandon, once and for all, the "Open Door" approach of the early twentieth century, which in many respects our trade policy today vis-a-vis China has once again become.<sup>50</sup> Open Door rhetoric and indecisiveness of policy makers could prove fatal in Sino-American relationships

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<sup>50</sup> "History of American diplomacy in the Far East from 1903 - 1938 recapitulates in a series of cycles the experience of John Hay [and the Open Door Policy]. One after another, with variation only in the manner and emphasis, the Presidents and Secretaries of State who followed McKinley and Hay have moved toward identical objectives with identical results." Quoted by A. Whitney Griswold,

and unwittingly kill the natural development of a rule-of-law society let alone destroy a naturally fertile environment for U.S. investment (even if investment incentives should disappear).

A "sea of change" is occurring throughout the Asia-Pacific region, but not for the same reasons given by Abegglen. It is not just a shift of Japan to Asia-Pacific, but more importantly a return to China as the center of Asia-Pacific economic development. China is fast approaching (if not already there in certain areas such as Shanghai) a period of economic growth which will place renewed emphasis on consumption and technological advancement. The concurrent developments of structural renovation in the coastal cities and other regions juxtaposed with great strides in technological advancement emerging from China's research institutes and academia is unprecedented. Sustenance for such development will draw from several sources, not the least of which is China's long legal heritage. This metamorphosis will continue, however, regardless of what form U.S. trade and investment policies take. Therefore, the real risk is whether U.S. industry can continue to play an integral role in Chinese economic development. The answer will be yes, but only if we become more Chinese in our approach to doing business and drop our insistence that China become more western over time.

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