



WPS-1198

Legal Department
The World Bank
September 1993
WPS 1198

Enterprise Reform in China

The Evolving Legal Framework

Natalie Lichtenstein

How far legal reform has gone, and where it needs to go, to support enterprise reform and provide the legal environment needed for China's transition to a "socialist market economy."

This paper — a product of the Legal Department — is the first in a series of staff publications intended to provide information and analysis of legal issues relevant to development. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Malini Rangarajan, room MC6-367, extension 81710 (September 1993, 39 pages).

Enterprise reform in China since 1979 has been supported by accelerated reform of China's legal framework. In the transition to a "socialist market economy," state enterprises will operate independently of the government, may no longer be fully owned or controlled by the state, and will deal with the state and other legal entities through market-based transactions. The number of collective (township and village) enterprises has grown rapidly, and in recent years so has the number of private enterprises.

This level of economic change requires a commensurate level of legal change. Lichtenstein describes the legal framework needed for enterprise reform in the world's most populous country.

First, it is essential to define the enterprise and its rights and obligations. To define and broaden the autonomy of enterprises, *enterprise law and company law and regulations* must be reformed. For state and collective enterprises, a goal of legal reform is also to effect the separation of ownership and management. To create a legal environment in which all enterprises — including state enterprises — participate as independent economic actors, reform is also needed in the following areas:

- *Bankruptcy and competition law*, to promote fair, effective competition among autonomous enterprises and to ensure the continued protection of the public interest even without direct state management of enterprises.
- *Financial laws, including securities laws and regulations*, so enterprise financing can take

place in a market-driven system rather than through a planning mechanism.

- *Laws governing land use, mortgage financing, and pension and social security systems*, to separate employee housing and pension and social security systems from enterprise obligations and henceforth to provide housing, pensions, and social security through alternative means.

- *Contract law*, to protect the legal rights of enterprises and allow economic transactions between parties to replace administrative controls, and to ensure that the *court system and dispute resolution processes* function credibly and reliably, thereby making all other reforms enforceable.

To make these reforms meaningful, *property rights* must also be better defined. China's civil code currently offers only a limited definition of the rights of ownership and of an enterprise's rights to sell, transfer, or otherwise dispose of property.

Lichtenstein catalogs these pieces of the legal framework, suggesting where further reform is needed to support enterprise reform. She focuses on the reform of state enterprises but also discusses the reform of nonstate enterprises. She touches only lightly on the role of foreign investment but does not address the developing framework of patent, trademark, and copyright laws.

The Policy Research Working Paper Series disseminates the findings of work under way in the Bank. An objective of the series is to get these findings out quickly, even if presentations are less than fully polished. The findings, interpretations, and conclusions in these papers do not necessarily represent official Bank policy.

**ENTERPRISE REFORM IN CHINA:
THE EVOLVING LEGAL FRAMEWORK**

Natalie G. Lichtenstein
Legal Department
The World Bank

Preface

This is the first in a series of staff publications by the World Bank's Legal Department which are intended to provide information and analysis of legal issues relevant to the Bank's development mandate. While the publication of these papers will constitute a resource for the staff of the Bank and the borrowing countries concerned, it could obviously have wider benefits and serve to enhance public awareness of the linkage between legal reform and development in general and the relevance of such reform to private sector development in particular.

Natalie Lichtenstein's paper describes the legal framework for enterprise reform in the world's most populous country. It provides an overview of the legal reforms introduced to date and of the areas where further reforms are needed to help China in its impressive economic and social development. As the Bank's lawyer most familiar with the Chinese legal system and language, Ms. Lichtenstein is particularly qualified to address these subjects. Outside scholars of Chinese law have reviewed this paper and found it to be a concise overview of the legal framework which is both comprehensive and accurate. It provides a model to be followed by the other papers contemplated in this series.

Ibrahim F.I. Shihata
Vice President and General Counsel
The World Bank

CONTENTS

I.	INTRODUCTION.....	1
II.	DEFINING THE ENTERPRISE AND ITS LEGAL RIGHTS AND OBLIGATIONS.....	3
	A. STATE ENTERPRISE AUTONOMY.....	3
	B. STATE ENTERPRISE GOVERNANCE.....	6
	C. NON-STATE ENTERPRISES.....	8
	1. Collective Enterprises.....	8
	2. Private Enterprises.....	9
	D. STRUCTURING ENTERPRISES AS COMPANIES.....	11
	1. Current State of Legislation.....	11
	2. Types of Companies.....	13
III.	A COMPETITIVE ENVIRONMENT.....	17
	A. BANKRUPTCY LAW.....	17
	B. COMPETITION LAW.....	18
IV.	FINANCIAL LAWS.....	21
V.	REMOVING THE SOCIAL BURDENS OF THE ENTERPRISE.....	23
	A. HOUSING: LAND USE AND MORTGAGE LAW.....	23
	B. SOCIAL WELFARE RIGHTS.....	24
VI.	PROTECTING THE LEGAL RIGHTS OF THE ENTERPRISE.....	26
	A. CONTRACT LAW.....	26
	B. COURTS AND DISPUTE RESOLUTION PROCESSES.....	27
	C. LEGAL INSTITUTIONS.....	28
VII.	CONCLUSIONS.....	29
	Annex 1 (Table of Legislation).....	30
	Annex 2 (Basic Forms of Shareholding Enterprise).....	36

The author wishes to acknowledge the helpful comments made on previous versions by William Alford, James Feinerman, Susan Finder, Peter Fox, Peter Harrold, Sherif Hassan, Tariq Hassan and Nena Manley.

**ENTERPRISE REFORM IN CHINA:
THE EVOLVING LEGAL FRAMEWORK**

I. INTRODUCTION

1. Enterprise reform in China since 1979 has been supported by an accelerating evolution in accompanying reform of the legal framework. State enterprises are in a transition to a "socialist market economy", in which they will operate independently of the government and may no longer be fully owned or controlled by the state, and will deal with both the state and other legal entities through market-based transactions. Collective enterprises have grown rapidly, in the form of township and village enterprises; in more recent years, private enterprises have also developed in increasing numbers. Thus, the legal framework necessary for enterprise reform is comprehensive as the economic reform of enterprises requires changes in many areas of economic behavior.

2. Defining the enterprise and its rights and obligations is at the core of the legal framework for enterprise reform through reforms of enterprise law and company law and regulations necessary to define and broaden enterprise autonomy. For state and collective enterprises, the legal reforms also seek to effect the separation of ownership and management. These core reforms must be accompanied by other reforms which are needed to create a legal environment in which all enterprises, including state enterprises, participate as independent economic actors.

(a) development of a competitive environment through reforms in bankruptcy and competition law, promoting fair and effective competition among autonomous enterprises and ensuring that the public interest continues to be protected even without direct state management of enterprises;

(b) reforms in financial laws, such as securities law and securities regulation, necessary for enterprise financing to take place through a market-driven system rather than through a planning mechanism;

(c) separating employee housing and pension and social security systems from the obligations of the enterprise, with reforms in the laws governing land use, mortgage financing, and pension and social security systems necessary to ensure alternative means of providing housing, pensions and social security; and

(d) protecting the legal rights of the enterprise through reforms in the

laws on contracts to allow economic transactions between parties to replace administrative controls and to ensure that the court system and dispute resolution processes function credibly and reliably, making all of these other reforms enforceable.

For all these legal reforms to be fully meaningful, greater definition of property rights will also be needed. Currently, the Civil Code offers only a limited definition of the rights of ownership and of the property rights (disposition, transfer, sale) of enterprises.

3. In most if not all of these areas, the legal framework is beginning to emerge, as legislation is enacted (if not perfect). This paper attempts to catalogue these pieces of the legal framework, and to suggest where further developments are required to support full-fledged enterprise reform. While this paper focusses primarily on state enterprise reform, the reform of non-state enterprises is also discussed. The role of foreign investment in enterprise reform, while important, is considered here only briefly, since much has been written elsewhere on China's foreign investment legislation. Similarly, intellectual property laws are not addressed, although the developing framework of patent, trademark and copyright laws will have some impact on enterprise development.

II. DEFINING THE ENTERPRISE AND ITS LEGAL RIGHTS AND OBLIGATIONS

4. The laws relating to enterprise formation and operation and companies have been developed slowly over the reform period. Several important areas have been addressed in increasingly detailed fashion: operational autonomy and governance (including internal enterprise management) for state enterprises, the rise of collective and private enterprises and, in parallel, adoption of corporate form. State, collective and private enterprises are discussed separately in this section, because the current legal framework has different legal rules for enterprises under these different categories of ownership. However, full-fledged enterprise reform would lead to a consolidation of the legal rules, applied equally to enterprises regardless of ownership.

A. STATE ENTERPRISE AUTONOMY

5. Early in the reform process, in 1983, provisional rules were enacted governing the rights and duties of state industrial enterprises, and providing for a limited sphere of autonomy for their operation. Under the 1983 State Industrial Enterprise Provisional Rules, state enterprises were first obliged to ensure that the planned tasks set down by the supervisory unit were fulfilled; only then were they allowed to determine their supplemental production, and within the scope of state regulations, select and purchase goods, sell products, determine prices, utilize enterprise funds and determine wages and bonuses for workers. The supervisory unit approved the enterprise's annual production plan, technical transformation program, investment budget and product orientation. State Council regulations promulgated in 1984 provided some additional flexibility, permitting enterprises to retain seventy per cent of depreciation funds and dispose freely of some other enterprise funds, produce and sell a broader range of products, set prices within twenty per cent of state prices and exercise greater decision-making in hiring and promotion of workers.

6. Further legal specification of state enterprise operating rights came with the enactment of the 1988 State Industrial Enterprise Law. The enterprise's right, under the Law, to hold, use and legally dispose of assets the state authorizes it to manage does not differ from the Provisional Rules, nor for that matter from the relevant provisions of the Civil Code General Principles enacted in 1986. As under the Provisional Rules, the enterprise may lease out or "transfer for compensation" its fixed assets, but governmental department approval is required where these assets are neither idle nor excess. Several new

enterprise rights are explicitly included in the Law, such as the right to plan production of goods or provision of services needed by society, the right to use its foreign exchange portion, the right to invest in other enterprises and the right to issue bonds. Other rights are similar to those under the Provisional Rules, although generally more clearly and sometimes more broadly stated, such as the rights to market its goods, choose suppliers, set prices and utilize its capital.

7. Nonetheless, it is important to note that most of the rights are subject to "regulations by the State Council" and, in practice, enterprise enjoyment of these rights has not necessarily followed their legal definition. From a legal perspective, if enterprise rights have not been exercised to the fullest, some of the cause may lie in the vagueness with which they have been granted. Qualifying each right with reference to separate regulations means, as a legal matter, that the enterprise lacks the certainty as well as the clarity that is necessary for any economic player to play its role fully.

8. The legal vagueness surrounding enterprise rights has been substantially alleviated with the most recent regulations, the Regulations on Transforming the Management Mechanisms of State-Owned Industrial Enterprises. The main thrust of the 1992 Regulations was to strengthen and broaden the operating autonomy of state enterprises by specifying fourteen management rights which would henceforth be exercised by the enterprises themselves rather than the government departments concerned. Those management rights are:

- (a) production and management decision-making powers;
- (b) the right to decide prices of products and services;
- (c) the right to sell products;
- (d) the right to purchase goods and materials;
- (e) import and export rights;
- (f) the right to make investment decisions;
- (g) the right to determine application of reserve funds;
- (h) the right to dispose of assets;
- (i) the right to operate joint ventures or undertake mergers;
- (j) the right to hire workers;
- (k) the right to determine personnel management;
- (l) the right to determine distribution of wages and bonuses;
- (m) the right to decide the organization of internal units; and
- (n) the right to refuse proration (demand for resources from government departments).

These rights are described in greater detail than under the Law, though the scope

of autonomy is still qualified in certain respects. For example, the right to decide prices does not apply to individual products whose prices are controlled by the price departments of the State Council, nor to prices of the means of production included in the lists issued by those departments and their local counterparts, nor to those products and labor services whose prices are governed by law. Prices for processing, maintenance, technical assistance and other labor services are decided by the enterprise themselves. This illustrates the improvement over the vaguer provision in the Enterprise Law, since at least the particular scope and limits of prices subject to state regulation are spelled out. Moreover, there are no limits on service prices, except as stated in particular laws.

9. Similarly, the import and export rights extended to an enterprise include the right to select foreign trade agencies from any part of the country to undertake import and export business, to utilize freely foreign exchange earnings (in compliance with foreign exchange control provisions), to undertake projects and provide services abroad and to import equipment, goods and materials for enterprise use (in compliance with import regulations). However, the Regulations still reserve the right to engage directly in import-export activities for enterprises that have favorable conditions and approval by the relevant government departments; in practice, national and local state trading corporations continue to play a role.

10. The same kind of broad definition of rights with limited exceptions, clearly spelled out, applies to most of the other rights as well. As a result, the 1992 Regulations can be viewed as giving needed content to the ubiquitous phrase in the 1988 Law, "in accordance with state regulations". These Regulations demonstrate a reasonable attempt to balance the need for clarity and certainty to bring enterprise autonomy fully into play with the current policy decision to retain government control of parts of the economy and certain economic decisions. Moreover, more detailed local provisions implementing the Regulations are being drafted in jurisdictions such as Shanghai. It remains to be seen in practice whether the actual devolution of authority from the state to the enterprises will follow the legal provisions providing for it.

11. The importance of the new operating mechanism is evidenced by the 1993 amendments to the Constitution, which better reflect the economic structure of the country and the coming socialist market economy. All references to state-run enterprises are changed throughout to state-owned enterprises, and wording more consistent with the new operating mechanisms is used to describe their relationship to the state. More generally, the amendments make minor adjustments in wording to add reform and the socialist market economy to the economic

principles referred to in the Constitution, and correct references to such economic forms as rural people's communes which are no longer relevant. These changes can be seen to reflect a consensus at the highest level for the transformation to a socialist market economy. Moreover, the fact that the leadership considers it necessary to change the country's basic legal instrument in order to provide a firm base for the reforms reflects, a heightened concern for the use of legal instruments to effect reform.

B. STATE ENTERPRISE GOVERNANCE

12. Under the 1983 Rules, the decisions of an enterprise could not conflict with those of the supervisory unit, and while the enterprise could raise suggestions, the supervisory unit's final decision was binding. The 1988 Law appears to have been intended to remedy that situation, by providing that

Relevant government departments (and social groups) shall not violate enterprises' legal autonomy. They shall not request support from enterprises in terms of manpower or material and financial resources. They shall not request an enterprise to set up a certain organ or determine the size of its staff.

If a relevant government department violates these restrictions, the enterprise has the option to request compliance, and then to petition the next higher level government organ to adjudicate. If the enterprise is dissatisfied with that organ's ruling, it may appeal to the people's court. It would be interesting to know whether these provisions have ever been tested in arbitration or litigation.

13. The 1992 Regulations also addressed the evolving relationship between the government and the enterprise, in three main ways:

(a) First, the Regulations include a chapter on enterprise responsibility for profit and loss, which details certain standards to be met (restraining and supervising distribution, limits on retained wages as enterprise wage reserve fund, profit delivery prerequisites for cash awards to managers and employees, to name a few). This chapter gives some meaning to the oft-stated "responsibility for profit and loss" while introducing some administrative mechanisms to protect against losses (which the state, as owner of state enterprises, has every right to do).

(b) Second, the role of the government under the transformation of management rights is described in a separate chapter, which specifies the

functions of government departments in exercising ownership rights in the enterprises, in strengthening macroeconomic regulation, in developing a market system and in providing social services to enterprises. This new role for government differs markedly from the kind of control exercised by the government supervisory department in the planning model, and will require substantial restructuring and reorienting in the transition.

(c) Finally, if the government infringes on the legal autonomy of an enterprise, it would be held legally liable. Indeed, the Administrative Litigation Law now offers a mechanism for enterprises to seek remedies for government infringement.

This kind of distinction between the government as owner and the government as regulator, separated from the enterprise management, is exactly the kind of structure that has been the focus of previous policy discussions on state enterprise reform. While the precise formulation of each provision may merit further review, the structure and drafting of the Regulations does represent a meaningful step forward in state enterprise legal reform.

14. As for internal enterprise management, the autonomy of enterprise managers has been a focus of the reform program and has been strengthened under the legislation. Under the 1983 Rules the factory director was designated the legal representative and the leading administrator of the firm, but operating under Party Committee leadership. With the introduction of the 1986 Factory Director Rules, the factory director not only is the legal representative of the enterprise but also has the central leadership and overall responsibility for production, operation and management. The factory director is encouraged to seek advice on a number of specified issues from an advisory group, the management committee, composed of the factory director, deputy directors, chief engineer, chief accountant, secretary of the party committee, trade union president, secretary of the communist youth league and workers' representatives. The management committee lacks any legal decision making power, as evidenced by the provision that, when matters discussed by the management committee require approval by government authorities or review by the workers' congress, the factory director makes the appropriate report or resolution. Where the factory director and the management committee (acting by a majority) differ on the important matters, the right of final decision rests with the factory director.

15. While the 1986 Factory Director Rules have yet to be updated to conform fully to the 1988 Law, the 1988 Law does enhance the role of the factory director in several ways. First, the Law provides that the factory director is legally responsible for the enterprise's operations in all areas and enjoys legal

protection in the exercise of the director's powers, within the scope of autonomy granted to the enterprise. Furthermore, the factory director is no longer under the Party Committee's leadership; rather, the Law provides that the Party Committee supports the director in discharging his or her authority according to law. This seems to offer more autonomy to the factory director than the 1986 Rules, although it is unlikely that the situation will have changed everywhere in practice. The Law, like the Rules, establishes a management committee, but, unlike the Rules, it does not require Party participation. The Law also provides for different methods of factory director appointment and different responsibility. The 1992 Regulations do not address this aspect.

C. NON-STATE ENTERPRISES

1. Collective Enterprises

16. Collective enterprises had been protected under the Constitution for decades, and provisions for their registration as legal persons had existed even before the General Principles of the Civil Code and the Enterprise Legal Person Registration Regulations. It was not until 1990, however, that the legal framework for the structure and governance of collective enterprises gained definition under the Regulations for Rural Collective Enterprises. These were followed in 1991 by the Regulations for Urban Collective Enterprises. These Regulations provide for the establishment, registration, management and operation and termination of rural collective enterprises (those run by township and village peasants' collectives) and urban collectives (those run by mass labor collectives in urban areas). Both sets of Regulations attempt to clarify the legal ownership rights and autonomy of collective enterprises, providing that the enterprises are legal persons which enjoy protection under the law.

17. The Urban Collective Enterprise Regulations provide somewhat more clearly for ownership rights to be exercised by the workers assembly, which selects the enterprise management, as well as for management functions and relationship with government. The Rural Collective Enterprises Regulations are briefer (45 articles, rather than 70 articles) and are less clearly drafted. For example, these Regulations speak of the property of the enterprise being owned by the entire peasants' collective, with the proprietary rights exercised by the peasants' congress or collective economic organization representing all peasants. Again, confusion is introduced by the subsequent references to the rights and obligations of the owner of the enterprise, such as determining the enterprise's orientation, business line, manager (or method of selecting the manager) and distribution of after-tax profit. One would assume that references to the owner must mean the collective which exercises proprietary rights, but there is no clear connection between the provisions.

18. In any event, the provisions on the separation of management are clear, specifying the qualifications and rights of enterprise managers, as are the provisions specifying the autonomy of the enterprise in operation, such as setting prices for non-controlled goods, hiring employees, entering into economic contracts and undertaking external trade. Moreover, the collective nature of the rural collective enterprise is preserved in several ways. For one, collective enterprises may attract investment from other investors "so long as the nature of the enterprise does not change." In addition, the Regulations specify that at least 60% of the after-tax profit should be retained by the enterprise, whether for reinvestment, technological transformation or bonuses, while the balance should be used for agricultural infrastructure and renewal and development of other enterprises.

19. These Regulations take the legal framework for collective enterprises one step forward, by giving some contours to their legal status, rights and obligations. In light of the new operating mechanisms recently introduced for state enterprises, though, it may be opportune to revise the legal framework for collective enterprises to enjoy the same scope of operational autonomy as now offered to state enterprises. At the same time, it would be helpful to consolidate legal framework for all collective enterprises, whether or not they meet current definitions of urban and rural.

2. Private Enterprises

20. Unlike collective enterprises which have been part of the economy since the beginning of the People's Republic, private enterprises were dismantled in the 1950s and only re-emerged during the reform period of the 1980s. Individuals were permitted to establish enterprises, which became known as individual households (getihu) under the 1982 Constitution and the Civil Code. Under various regulations the number of employees working in such households or other private entities was limited at times to 7, but in practice private enterprises with many more employees sprang up. It was not until 1988 that the Constitution was amended to permit private enterprises to be established and enjoy legal protection from the state. Shortly thereafter, the Private Enterprise Regulations and related tax provisions and implementing measures were enacted to provide a more comprehensive legal framework for private enterprises.

21. The Regulations gave structure to a defined category of private enterprises, namely those which are profit seeking economic organizations employing 8 or more persons whose property is privately owned. Private enterprises can be organized in one of three forms: sole proprietorship, partnership and limited liability company. The forms differ in number of owners,

their liability and their legal status. Sole proprietorships have only one owner who bears unlimited liability for the obligations of the enterprise; partnerships have two or more owners under a written agreement, each of whom assumes joint and unlimited liability for the obligations of the enterprise. Limited liability companies have two to thirty owners (an exception for a higher number can be requested), each of whose liability is limited to his or her investment. The Regulations specifically provide that private enterprises in the form of limited liability companies are legal persons; for sole proprietorships and partnerships, only the legal representative of the enterprise is specified.

22. The Regulations do not limit the size or capital of enterprises but rather limit the types of individuals who may establish them. These individuals must fall in the following categories: rural residents, unemployed individuals in cities and townships, operators of individual and commercial households, employees who have resigned or been discharged and others leaving or retiring from their positions, as further defined in the implementing measures. The business lines available for private enterprise are limited, however, to seven basic trades: industry; construction; communications and transport; commerce; food and beverage; service and repair; and technological consultancy.

23. Certain other restrictions on private enterprise can be seen as manifestations of the desire to control the potential for excess. For example, the salary of the director of a private enterprise is stipulated not to exceed ten times the average staff wages. The enterprise is required to retain at least 50% of after-tax profit in the production development fund. Further retention of profits in lieu of distribution to individual owners is encouraged by the exemption from the 40% tax on after-tax profit distributable to owners for additional amounts retained in the production development fund. Social concerns are noticeable in the requirement of an 8-hour day and prohibition of child labor, a level of detailed management that is not specified for state and collective enterprises. Enforcement of the regulations is also addressed: first, by specifying the State Administration for Industry and Commerce to administer the Regulations, and second, by providing the private owner with the right to request administrative reconsideration and to go to court if dissatisfied.

24. Private enterprises are also granted rights and obligations similar to those of collective enterprises. Among other things, they can operate autonomously, recruit workers, enter into contracts (including mandatory labor contracts), work out prices and apply for patents and trademarks. If a private enterprise is "bankrupt," it is required to liquidate its assets and pay its obligations. These rights must be balanced against the limitations noted above,

in assessing the scope for autonomy in operations offered by the legal framework. Fuller enterprise reform would lead to reduction or removal of these limitations; so far, the policies supporting the development of private enterprises have fluctuated in the period since the Regulations were enacted.

D. STRUCTURING ENTERPRISES AS COMPANIES

1. Current State of Legislation

25. Company law. One important area in which the legal framework for enterprises has been lacking is in the establishment of organizational forms. Throughout the reform period, enterprises have almost interchangeably called themselves companies and enterprises. State enterprises, at least, were given a basic definition in the 1988 Enterprise Law, but the term "company" had no legal definition in Chinese law. Indeed, at one stage (1985), there were separate registration requirements for companies (including capitalization requirements) even though there was no separate legal status for companies. Subsequently, the 1988 Enterprise Legal Person Registration Regulations repealed previous rules and combined the registration requirements for all enterprise legal persons.

26. One limited exception to the lack of company law noted was the introduction in 1990 of the limited liability company form for private enterprises, although the provisions of the Private Enterprise Regulations for such companies do not address much of the corporate legal framework normally found in company law. Moreover, there is a process of "chartering" enterprises in which specific powers and duties are set out in a charter issued by the supervisory department, and the charter is required for registration as an enterprise legal person. However, these charters frequently do not clarify the legal powers and corporate structure of the enterprise to the same extent that even the current shareholding legislation would provide.

27. Notwithstanding the lack of a proper legal framework, shareholding companies (also translated as joint stock companies) have been springing up all over China for about five years now. The only two areas in which the "shareholding experiment" was officially sanctioned were in Shanghai and Shenzhen. Both municipalities also established securities exchanges for the trading of share in these companies in 1990, although shares had been actively traded in the financial markets before the exchanges were established. Yet, it was not until the enactment of the Shenzhen provisional company regulations in March 1992 and the Shanghai provisional company regulations came into effect in June 1992 that there was a legally discernible and enforceable definition of the rights carried by the shares being traded. Thus, from the point of view of establishing a proper legal definition of rights and duties, the Shanghai and

Shenzhen regulations constitute an important part of the legal framework for companies. (The limited liability companies under the Private Enterprise Regulations are not permitted to issue shares to the public.)

28. It is recognized, however, that a national legal framework for companies is also necessary. Not only is it desirable to spread nationwide the benefits of the corporate form (limitation of shareholder liability and enforced separation of the government as owner of shares from the management of the enterprise), but a single set of rules for corporate organization would facilitate interprovincial operations of companies and sales of shares. For instance, a buyer in Liaoning could know whether the president or the chairman of the board of the selling company in Shanghai had to sign a contract before the buyer could rely on it--without having to consult various provincial laws on the subject. Thus, a company law of nationwide applicability remains an important goal.

29. There is yet no national company law, although a draft company law, revised from last August, was considered by the 30th session of the Standing Committee of the National People's Congress in February 1993. Unlike the August version, which only covered limited liability companies, this version reportedly includes limited liability companies, limited share companies, Chinese branches of foreign companies, joint companies and single-owner companies (an important category for state enterprise reform). So far, it apparently does not cover partnerships or unlimited companies. The revised draft is expected to be approved at the August 1993 session of the Standing Committee.

30. The Shareholding Experiment. While enactment of the company law is hoped for in 1993, in the spring of 1992 several parts of the corporate legal framework were established, which can be thought of as a functional substitute for a company law in the interim. On May 15, 1992, five agencies under the State Council (but not the State Council itself) issued the Measures on Enterprises' Shareholding System Experiment --State Commission for Restructuring the Economic System (SRC), State Planning Commission (SPC), Ministry of Finance (MOF), People's Bank of China (PBC) and the State Council Production Commission (now known as the State Economic and Trade Commission). While the Measures do not themselves set out the provisions of a company law, they permit the establishment of shareholding companies throughout China, and they require that these companies be established as either limited share companies or limited liability companies. Most importantly, the Measures mandate that all shareholding companies follow strictly the provisions of two relevant documents issued by SRC, also on May 15, 1992: the Views on Standards for Limited Share Companies and the Views on Standards for Limited Liability Companies. These two

documents, the Limited Share Company Standards and the Limited Liability Company Standards, are in the form of guidance from SRC, but they are structured as if they were laws (which they are not). The measures themselves are unusual, but probably binding; by requiring companies to follow the standards, this gives the Standards legal force.

31. This issuance of directives by several agencies coupled with guiding directives from one agency is not a substitute under Chinese law for the enactment of regulations (by the State Council) or laws (by the National People's Congress or its Standing Committee), under Chinese law. It is essentially a stop-gap measure to provide some legal basis in advance of formal enactment of legislation. However, the two Standards were subsequently supplemented with regulations from various agencies on relevant aspects of shareholding companies, enacted under normal administrative procedures. These regulations cover financial management (MOF, SRC); accounting (MOF, SRC); registration and management of state assets (State Assets Management Bureau, MOF and State Administration for Industry and Commerce); taxation (State Taxation Bureau, SRC); labor and wages (Ministry of Labor, SRC); macro-economic control (SPC, SRC); auditing (State Audit Administration, SRC) and land administration (State Land Administration Bureau, SRC).¹ While these regulations apply only to the so-called experimental shareholding enterprises, they could eventually form the basis for regulations to apply to all companies, once a nationwide company law is enacted.

2. Types of Companies

32. Based on the shareholding regulations, it is also clear that China is likely to have several types of companies established under nationwide company law, whether in one or several pieces of legislation. The Measures and the Standards provide for two basic types of companies, limited share companies and limited liability companies. Draft legislation in the past several years has also been divided into limited share companies and limited liability companies, largely because, as noted below, limited liability companies do not touch upon the notion of public ownership of shares. However, it appears that the company law draft (noted in para. 29 above) is likely to include various types of companies.

33. Both types of shareholding company under the current legislation limit the liability of shareholders to the amount of contribution. Limited

¹ A list of titles and dates can be found in the list of legislation in Annex 1.

liability companies have a limited number of shareholders (2-30), transferability of shares is limited and "stock" is not issued. Limited share companies have equal shares with no limit on the number of shares, "stock" can be issued, with approval, to the public, and shares can be transferred. As currently structured, neither of these corporate forms can be used for a state enterprise with only one shareholder. However, with two shareholders (possibly two state enterprises or government departments), a limited liability company can be formed, and a large state enterprise can, with approval, be a sole incorporator in some types of limited share company. Either form would permit cross-ownership of enterprises, while direct individual employee ownership of shares is only permitted in limited share companies.

34. Within the category of limited share companies, the legislation currently provides for several sub-categories:

- (a) "incorporator-held", in which funds can only be raised from incorporators and transferred among legal persons;
- (b) "fixed-channel fund-raising", in which funds can be raised from shares sold to incorporators, other legal persons, and, with approval, to company employees (not exceeding 20%), and can only be traded among those classes, with incorporators holding at least 35% of the shares; and
- (c) "public fund-raising", in which funds can be raised from the public as well as incorporators, transferability is not restricted, and incorporators hold at least 35% of the shares, the public at least 25%, and employees not more than 10% of publicly-held shares.

There are many more distinctions, which are illustrated in the chart in Annex 2. Whether such complex classifications are needed to achieve particular policy goals at this juncture in the development of shareholding companies in China is another area for further analysis.

35. A full analysis of the provisions of the two Standards and the supplementary regulations is outside the scope of this paper. A preliminary overview of the Standards, however, reveals that much improvement could be introduced by making changes in two fundamental thrusts of the legislation. First, there are numerous references to "relevant government departments" and to the need for approvals by and notices to them. To make the most of the economic opportunities, companies need to make economic decisions with certainty about their legal rights and enough speed not to lose those opportunities. If the legislation requires a company to get approvals from unnamed government departments, the company has no certainty about when it has gotten all the necessary approvals and is always subject to interference from another agency

which may decide that it is "relevant". Reducing the number of such approvals to the minimum necessary to protect the public interest in sound corporate organization and specifying either in the Regulations or in a separate document the relevant agencies would help to ameliorate this pervasive problem.

36. The second major area in which the Standards could be made more "market-friendly" to take full advantage of the benefits of the corporate form would be to restate the requirements for companies to "safeguard the interests of the State and the public interest". The corporate model succeeds elsewhere because there is the clarity of a single corporate purpose: to generate profits for the shareholders. If the company is wholly or partially government owned, then the government as the shareholder of the company can provide in the company's charter and operation for protection of the public interest if that is its purpose. The public interest is safeguarded by the company's respect of applicable laws and regulations. Similarly, there are requirements for government approvals of company decisions (capital increase, merger, termination, etc.) which limit the ability of shareholding companies to make decisions about their financing, investment and operations. In addition to these two major concerns, there is also considerable scope for improvement in the detailed provisions, with a view towards making the corporate form in China as useful a vehicle for economic development as it has been elsewhere.

37. Neither the Standards nor the regulations offer extensive legal provisions governing two frequently-mentioned vehicles for enterprise combinations, holding companies and enterprise groups. The Limited Liability Company Standards do, for the first time, clarify that the subsidiaries of a holding company are independent companies whose shares are held by the parent whereas branch companies are separating operating entities but not separate legal entities. Beyond that, more regulation of holding companies would be expected to be found either in a company law or in separate legislation.

38. Similarly, the enterprise group phenomenon, in which several enterprises are linked in some amorphous and possibly contractual way into an enterprise group, would also benefit from the clarity and scope of legal rules that company law could offer. There is a State Council policy document of 1991 on the formation of large enterprise groups. However, the only formal legal provisions are found in the Provisional Implementing Rules for Enterprise Group Registration, issued by the State Administration for Industry and Commerce (SAIC), SPC, SRC and the Production Office in May 1992. These Rules provide certain basic formation requirements for "state trial enterprise groups". State trial enterprise groups must have a strong core enterprise linked to at least three enterprises in close association through control of assets, and other

enterprises in semi-close or loose association, through "ties of assets". The core enterprise should be either a large state enterprise or a company controlled by state-owned shares:

- (a) An enterprise in close association is linked to the core enterprise in one of four ways: (1) the core enterprise has a controlling share of investment in the "close enterprise"; (2) the "close enterprise" is contracted or leased by the core enterprise on a long-term basis; (3) the "close enterprise" is a state enterprise approved for management by the core enterprise; or (4) the state asset management department has approved the transfer of the "close enterprise" assets to management of the core enterprise.
- (b) An enterprise in semi-close association should either be an enterprise in which the core enterprise holds a non-controlling share or an enterprise whose shares are wholly owned or controlled by a "close enterprise".
- (c) An enterprise of loose association is not tied to the core enterprise through assets, but either has a stable business relationship with the core enterprise or has part of its shares held by a close or semi-close enterprise.
- (d) A non-productive institution can become a member of an enterprise group.

All enterprises in an enterprise group remain as separate legal entities, and the enterprise group itself acquires legal personality upon registration.

39. While these basic provisions provide a framework for the organization of enterprise groups, they raise numerous questions of definition and interpretation. Moreover, these registration rules do not govern the operations and legal relationships of enterprise groups. By requiring an enterprise group charter to specify such matters as the internal governance processes, the rights and obligations of group members and the entry and exit rules, though, the registration rules do reach beyond registration to move enterprise group regulation towards a more coherent legal basis. Enterprise groups will also need to follow the restrictions in the Standards on crossholding of shares, since a company with more than 10% of its shares owned by another company may not purchase shares in that other company. Consequently, enterprise groups is another area in which enterprise reform would be furthered by filling the regulatory vacuum.

III. A COMPETITIVE ENVIRONMENT

A. BANKRUPTCY LAW

40. A bankruptcy law applicable to state enterprises was enacted in 1986 and became effective in 1988. The law is consistent with recent developments in bankruptcy law elsewhere, by providing for rectification and reform of those enterprises which can be saved, recover vitality and continue to operate. Provision is made for both voluntary bankruptcy, applied for by the enterprise, and involuntary bankruptcy, applied for by its creditors. Bankruptcy can be declared when an enterprise "has suffered serious losses and cannot pay its debts because of poor management." The procedure requires court action as well as government intervention through a liquidation committee appointed by the court from the departments concerned. A separate creditors' meeting is to be organized; secured creditors receive priority over other creditors. After payment of taxes and workers' salaries, unsecured creditors would be paid off on a prorated basis. Resettlement of workers is to be aided by the labor department and bankruptcy relief paid to workers. Managers would be subject to economic sanctions and criminal sanctions for dereliction of duty.

41. Similar liquidation provisions can be found in the shareholding company directives, although these provide that actual bankruptcy for shareholding companies would be handled by reference to the Bankruptcy Law. Both the liquidation provisions for shareholding companies and the Bankruptcy Law provide for preference for secured creditors, an important contribution of bankruptcy and liquidation to the development of financial lending instruments. As an indication of the importance attached to the factors leading to bankruptcy, the shareholding company legislation prohibits persons who bear the main responsibility for enterprises which were closed down or declared bankrupt from serving as corporate directors or managers for a period of three years.

42. The Civil Procedure Law, as enacted in 1991, does set out a procedure for liquidation in bankruptcy of non-state enterprises. Unlike the State Enterprise Bankruptcy Law, though, it does not provide for reorganization and rehabilitation of non-state enterprises. The Civil Procedure Law explicitly states that state enterprise bankruptcy shall follow the provisions of the State Enterprise Bankruptcy Law. In addition, the Supreme People's Court issued procedures for the handling of bankruptcy cases which form the basis for the cases handed thus far. Both national and local implementing regulations for the Bankruptcy Law are also under preparation.

43. The bankruptcy law is beginning to play a valuable role in providing

a set of incentives to managers to improve enterprise performance and in allocating enterprise risks among interested parties. Indeed, application of the bankruptcy law has begun to be reported publicly, although current limitations on the social safety net for displaced workers and the difficulty of making assessments of profit and loss in market terms are among the factors that make it likely to remain rare. One interesting note is that bankruptcy of collectively owned enterprises has also been reported, pointing up the need to revise the law to apply to all enterprises, not just state industrial enterprises. Revision of the bankruptcy law to incorporate bankruptcy in non-state enterprises and in particular, shareholding companies, will require some adjustment of the provisions, because the role of the government supervisory department under the law is considerable. For example, a public utility or other nationally important enterprise may stave off bankruptcy if the government department provides financial aid or takes measures to pay off the debts. Furthermore, any creditor-initiated bankruptcy can be discontinued when the government department requests consolidation and a reconciliation agreement is reached between the enterprise and its creditors. The enterprise itself can only initiate bankruptcy proceedings with the concurrence of the government department. Were the bankruptcy law to consider these actions as prerogatives of the enterprise owners rather than the "higher competent department," the law would be equally well applied to non-state enterprises as well.

B. COMPETITION LAW

44. While there is no comprehensive system of competition law in China, there are some legal provisions that refer to the need to ensure fair competition among enterprises and address concerns about monopolistic behavior. The 1980 Regulations on Socialist Competition, though somewhat obscure, provide:

Except for products which are under the special management of the departments concerned and units appointed by the State, no one is allowed to exercise a monopoly on the remaining products or act as the sole operator of a business.

Through the 1983 State Enterprise Rules, the state safeguarded lawful competition among enterprises and prohibited use of inappropriate methods (such as trademark fraud, consumer fraud, price control and bribery) and illegal methods to compete. The 1988 State Enterprise Law did not continue these provisions.

45. However, the Advertising Regulations, enacted in 1987, do continue the prohibition of the 1982 Provisional Advertising Rules on monopolizing and unfair competition in advertising are also prohibited. The Advertising

Regulations also prohibit publication of advertisements which "denigrate similar products", and provide a right of administrative appeal as well as appeal to the people's courts for losses to users or consumers or for tortious acts. Under the related implementing rules, monopolization in advertising can subject the violator to a criticism memorandum, confiscation of unlawful income, a fine of up to 5,000 yuan or suspension of business for reorganization. Interestingly, the Advertising Regulations and implementing rules also provide for consumer protection against deceptive and false advertising, with the same rights of appeal and similar administrative penalties. This nascent connection between competition law and consumer protection is common in market economies as well, where the same regulatory agency is frequently responsible for enforcement in both areas, albeit under separate legislative mandates.

46. The only recent enactment which touches on one of the core areas of competition law and policy are the merger provisions of the SRC Standards for Limited Share Companies. In one general statement without amplification, the Standards provide that approval of a merger may be withheld if the authorized government department considers the merger to violate state laws and regulations and policies prohibiting monopoly and unfair competition. Without any legal articulation of state laws and policies prohibiting monopoly and unfair competition, though, such a requirement is largely hortatory, and as yet there is no government structure focussed solely on the prohibition and punishment of anti-competitive behavior by enterprises.

47. Effective legal protection of inter-enterprise competition would require legislation to specify the forms of prohibited behavior (monopolistic, anti-competitive or exploitative) and the establishment of legal institutions and procedures to enforce this legislation. Special attention will be required for areas in which the state retains a monopoly. A draft "anti-unfair competition law" has had its first reading at the June 1993 session of the Standing Committee of the National People's Congress. It apparently is based on the draft fair trade law prepared by the State Administration for Industry and Commerce (SAIC). However, only prohibitions against unfair competition are included in the law, and anti-monopoly provisions are expected to be added in a few years. Other areas which might be expected to be addressed are cartels (horizontal and vertical), market power, concentration, bid rigging, market dominance, mergers and regional barriers.

48. Beyond preparation of a law, enforcement of competition law also raises institutional issues. Although criminal penalties are sometimes included along with civil penalties in such legislation, enforcement of competition law is frequently the province of a quasi-independent economic-oriented agency.

Moreover, since a comprehensive competition law would include review of enterprise mergers as well as anti-competitive behavior, it is important for economic policy reasons to maintain a relationship between the enforcement agency and the government's economic policy departments. For China, a new agency could be established for this purpose, or a new office could be added to an existing agency, such as the SAIC. SAIC (and its local level agencies) already have many enterprise related functions, including registration of enterprise and company establishment, mergers, terminations and changes of operations, trademark and advertising enforcement and contract arbitration. There may be some economies and efficiencies in locating a competition bureau in this agency.

IV. FINANCIAL LAWS

49. Trading in corporate securities, whether bonds or shares, is a necessary adjunct to market financing of enterprises. Three aspects of financial market regulations are essential to the legal framework for enterprise financing: definition of the rights associated with the securities, regulation of the securities markets, and provision of rules and procedures for transactions. The definition of rights in equity securities has been enhanced by the shareholding company legislation described above. Basic provisions for enterprise bonds were issued in 1987 by the State Council, covering a limited number of important aspects such as form of bonds, exclusion of management rights and transferability. There is still considerable scope for definition of other types of financial instruments, such as debts and commercial paper of enterprises. Clarifying the legal framework would support the development of various financing mechanisms for state and non-state enterprises alike.

50. Regulation of securities markets has been the subject of renewed attention, as the country's two securities markets in Shanghai and Shenzhen have attracted considerable activity and some concern. A national Securities Management Commission along with a securities regulatory body are being established. Depending on their precise scope of responsibilities and legal functions, this should be a welcome development. Until now, regulation of securities markets has not been specifically addressed in national law, although both Shanghai and Shenzhen have enacted regulations governing the issuance and trading of securities in their jurisdictions as well as regulating their securities exchanges. Since companies from other cities may now be listed in Shanghai and Shenzhen, this broadens the application of the regulations. Nonetheless, as regional and national financial markets develop, it will become increasingly desirable to have the same consistent set of rules applied everywhere, to facilitate interprovincial transactions. In addition, legal rules and safeguards will be needed for all players in these financial transactions, such as financial institutions, underwriters, dealers, appraisers, accountants and lawyers.

51. Progress towards meeting these needs for regulation of the securities markets is expected in 1993. A "Regulation on the Issuance and Trading of Stock" was issued by the State Council in April 1993, and "Regulations on the Administration of Securities Exchanges" were issued in July 1993. The April 1993 regulations cover issuance of stock by limited share companies and market trading of that stock; paybacks by listed companies; storage, settlement and transfer of stock disclosure of listed company information; investigation and penalties; and dispute settlement. By the end of the year, two other national

regulations are expected: regulations on employee shareholding in companies, and measures for the administration of public shares (that is, state shares and legal person shares in shareholding companies). A nationwide securities law is also being prepared. Its importance is underlined by the fact that the NPC Standing Committee is responsible for its drafting. This law would be expected to cover such areas as the securities regulatory structure, the issuance of shares (including the approval process), transactional rules (role of brokers, etc.) and legal prohibitions (self-dealing, insider trading). The China Securities Regulatory Commission (CSRC) itself has recently issued standards and rules on information disclosure, and has assisted in drafting codes of conduct for securities professionals and CSRC staff.

52. Overall reform of the financial sector will also have benefits for further enterprise reform. The availability of credit at a reasonable cost, of deposit facilities for surplus cash and temporary investment, and of facilities for prompt clearance and settlement of payments are essential elements for the development of a market economy. The preparation of a workable legal basis for the modern banking system which this will require has just commenced, and will involve further development of banking and bank regulation legislation, as well as laws to govern credit transactions and the payments system. Drafting work is underway on central banking and financial institutions laws, as well a national negotiable instruments law.

V. REMOVING THE SOCIAL BURDENS OF THE ENTERPRISE

53. Among the social burdens of state enterprises have been the provision of employee housing and social welfare benefits; this is much less of a problem for collective and private enterprises. Converting state enterprises into autonomous non-governmental operating economic entities requires development of alternative means of providing for the housing and social welfare of their employees. Removing these functions, and providing for employees equally regardless of the ownership structure of their employer, contributes to the "level playing field" among enterprises of different ownership.

A. HOUSING: LAND USE AND MORTGAGE LAW

54. The development of the laws necessary for an efficient and functioning housing market is a prerequisite to replacing enterprise delivery of housing to employees with market-based delivery of housing. Without clear legal definitions of property rights and a reliable means to enforce them, it is difficult for enterprises to be compensated appropriately for the housing stock currently under their control, for new managers of the housing to allocate it effectively to individuals, and for mortgage lending to provide an adequate basis for financing housing construction and sale.

55. A significant first step can be seen as the 1988 amendment of the Constitution to allow leasing of land while maintaining state ownership of urban land and collective ownership of rural land. Soon thereafter, the 1986 Land Law was amended, and provides a beginning definition of the land use rights and permits their transfer. National urban land use regulations appeared in 1990. These national urban land use regulations provide, inter alia, for specific maximum terms for land leases of different types, for transfer of land use rights for compensation, bidding and auction, for re-transfer of leases and for pledging of leases. In 1992, these regulations were further supplemented by provisional procedures on the administration of allocated leaseholds, which provide in more detail for their transfer, lease and mortgage. In addition, detailed local legislation on the transfer of land use rights for value exists in such places as Shanghai, Guangdong and Shenzhen, to facilitate the transfers of land use rights already taking place. Many other localities are in the process of issuing local legislation on land use, with particular focus on land use rights sold to and held by foreign investors. To support the use of land for housing, laws on tenancy and condominium rights are also necessary.

56. Land registration systems, which are crucial for transfers of land use rights to be meaningful, have also been developed over the reform period. However, a review of the legal framework points up some of the difficulties in this area. Different rights (such as the rights to buildings, land use and mineral extraction) may be registered under different legislation, by different agencies in different locations. As a result, purchasers of rights may find it difficult to ensure that all rights have been effectively and simultaneously transferred, and mortgage financiers may be reluctant to extend loans without assurances that their interests in all rights have been adequately secured. The state may also be disadvantaged, since the multiplicity of systems limits its ability to ensure that the different agencies permit the transfer of rights in a mutually consistent way, and priced in an efficient manner.

57. Finally, mortgage lending currently proceeds on a truncated and fragmented legal basis. The General Principles of the Civil Code recognize the pledge of specific property as security for a debt, and creditor's rights in respect of the property. These are only expressed as principles in the Civil Code, however, and detailed rules are not included. Beyond this, there is no national law on secured lending. Under the 1981 Economic Contract Law, Loan Contract Regulations were enacted in 1985, which permit secured interests under loan contracts. Several local jurisdictions, such as Shanghai and Guangdong, have enacted their own mortgage lending provisions. Not only would national legislation have the advantage of standardizing transactions and facilitating the development of interprovincial financial markets, but it would also be an opportunity to improve any imperfections in the local legislation.

B. SOCIAL WELFARE RIGHTS

58. One area in which legislation has touched upon the social welfare rights of workers in state enterprises is in the introduction of the labor contract system in 1986. At that time, provisional regulations were enacted on worker dismissal, recruitment, and unemployment insurance along with the regulations on the introduction of the labor contract system. Now that major changes are envisaged in this area, such as establishment of new systems and agencies, legislation will be needed to provide a firm legal basis for the reforms. Some analogies for this new legislation may be found in the provisions for labor management in foreign investment enterprises which have been developed both nationally and locally (e.g., the special economic zones) since the advent of joint venture legislation in the early 1980s. The legal framework can also be expected to enhance worker confidence in the system, which is essential to its smooth functioning, and to promote much-needed labor mobility. The importance

of this area for enterprise reform is presaged by the highly specific projections for workers in the Private Enterprise Regulations noted above. In addition, Regulations on Unemployment Insurance for State Enterprise Employees were enacted in April 1993, which provide for the establishment, management and operation of unemployment insurance funds.

VI. PROTECTING THE LEGAL RIGHTS OF THE ENTERPRISE

A. CONTRACT LAW

59. The use of contracts to initiate and regulate economic activity instead of administrative directives is an important step in developing the economic responsibility of the enterprise. Thus, when the Economic Contract Law came into force in 1982, it signalled the beginning of a process. The Economic Contract Law and the regulations under it governing various types of contracts (supply and installation, loan contracts, insurance contracts) provided a mechanism to permit enterprises to enter into economic transactions with other legal entities without going through the government bureaus and to enforce their rights in those transactions. While the Law states that contracts between individual business people and legal entities should be governed with reference to the Law, there is no reference to contracts between individuals. For the moment, contracts between individuals are addressed by the General Provisions of the Civil Code. (In contrast, contracts with foreign parties are governed by the Foreign Economic Contract Law, as well as any relevant international conventions to which China has acceded.)

60. Both the Economic Contract Law and the Civil Code stipulate the basic principles of contract, essential elements and liability for breach, although the Law (and supplementary regulations) offers a great deal of specific detail and the Civil Code offers only a few provisions. The Law also prohibits enterprises from unilaterally altering or terminating contracts, using coercion against the other party, or soliciting interference from outside. Moreover, because mediation or arbitration need not precede litigation in the case of default, the parties have greater control over dispute resolution.

61. Many of the provisions of the Law reflect the prevalence of mandatory planning at the time of enactment, and may well be suited to revision in light of the significant decrease in mandatory planning and significant increases in guidance planning and market transactions. For example, economic contracts that fulfill mandatory State plans must conform to State-set targets; contracts under guidance plans must take into consideration State targets as well as actual conditions. No specific reference is made to market-based transactions, given their rarity at the time. While these kind of provisions are increasingly irrelevant but harmless, there is a need to revise the continuing requirement that change or cancellation of an economic contract agreed by the parties must still not harm state interests or affect state plans. In addition to broadening the contract law to encompass more non-State economic activity, it would also be

opportune to revise the law to provide clear contractual rules on which individuals can rely for contracts among themselves. Indeed, revisions of the Economic Contract Law are currently under preparation and were considered at the June 1993 session of the Standing Committee of the National People's Congress. Approval at the August 1993 session of the Standing Committee is expected.

B. COURTS AND DISPUTE RESOLUTION PROCESSES

62. To create confidence in the economic rights of enterprises, to ensure the protection of those rights and to continue to provide for protection of the public interest even when government no longer controls enterprise operation, a well-functioning system for resolution of disputes is essential. In keeping with China's legal traditions, there is an emphasis on mediation and arbitration of disputes, but in recent years the court system has developed as well. The Civil Procedure Law, for example, provides in detail for the litigation of civil cases, but it also includes conciliation and the honoring of arbitration clauses in foreign economic trade, transport and maritime contracts. In the area of contract law, there is a system of contract arbitration and mediation for economic contracts generally whether by the SAIC, the courts or private parties. There are also provisions for arbitration of specific types of contracts, such as economic contracts and technology transfer contracts.

63. Economic chambers were established in the court systems early in the 1980s, however, and there has been a substantial increase in the number of cases coming to them and to courts generally. (The 1993 Report of the Supreme People's Court to the National People's Congress, for instance, notes that civil lawsuits have increased by 9.9% each year over the past five years, of which about 50% are divorce cases.) Whether enterprise managers have sufficient confidence in their avenues of legal recourse to exercise their rights and feel obliged to fulfill their obligations is not merely a reflection of the legal framework, of course, but that is an important part. Equally important are public and private perceptions, such as the concern frequently voiced that litigants from outside a jurisdiction are unlikely to get a fair result in litigation with a local entity. Judging these intangibles is likely to prove difficult for those outside of the Chinese scene, but at a minimum one can encourage further development of an efficient court and dispute resolution system in tangible ways. Two such improvements would be the continued development of a well-trained legal profession and the public availability of the laws that do exist.

C. LEGAL INSTITUTIONS

64. Protecting the legal rights of enterprises will also require strengthening legal institutions and changing the roles of governmental institutions. The court system referred to in paras. 62-63 above will need continued development, ensuring that court personnel gain experience and training in market transaction issues will be necessary. Specialized institutions, such as the SAIC and securities regulatory bodies, will need to develop institutional processes more in line with market orientation than with administrative controls. Government agencies are beginning the process of reorienting their functions and roles to reflect the changed role of government in a market economy. This pending change can be seen in the 1992 State Enterprise Regulations (para. 13) as well as in the restructuring of several ministries (e.g. textiles) as decided at the 1993 National People's Congress.

VII. CONCLUSIONS

65. It is difficult to offer meaningful conclusions about a body of law as vast and as changing as the one described in the preceding pages. The legal framework for China's economic transition to a market economy of which enterprise reform is an important part, is itself in transition. What is worth noting is the increasing recognition that legal reforms are necessary to bring economic reforms fully into play, as witnessed not only by the flurry of legislative activity documented here, but also by public pronouncements of Chinese leaders. Most recently, the new Chairman of the Standing Committee of the National People's Congress, Mr. Qiao Shi, has been quoted as saying:

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.

66. He also noted the need to draw on foreign experience in formulating economic laws and acknowledged that some current Chinese laws are unsuited to the reforms and require revision. If these remarks by a key legislative official are any guide, the next few years should see continued development of the legal framework for enterprise reform -- hopefully addressing the many facets discussed in this paper.

7/27/93

Table of References to Legislation
(not an exhaustive list of all relevant legislation)

A. Enterprise Law

1. {Provisional Rules for State Industrial Enterprises, promulgated by the State Council, April 1, 1983--superseded by the State Enterprise Law}.
2. Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People, enacted by the National People's Congress, April 13, 1988, and effective August 1, 1988 (State Enterprise Law).
3. Regulations on Transforming the Management Mechanisms of State-Owned Industrial Enterprises, promulgated July 23, 1992.
4. Regulations on the Responsibilities of Directors of State Industrial Enterprises, adopted September 15, 1986, effective October 1, 1986.
5. Regulations on Workers' Congresses in State Industrial Enterprises, adopted September 16, 1986, effective October 1, 1986.
6. Administration of Enterprise Legal Person Registration Regulations, promulgated by State Council June 3, 1988, effective as of July 1, 1988.
7. Detailed Rules for the Implementation of the Regulations Concerning Registration Administration of Enterprise Legal Persons, State Administration for Industry and Commerce, November 3, 1988.
8. Regulations on Rural Collective Enterprises, [State Council, June 10, 1990,] effective July 1, 1990.
9. Regulations on Urban Collective Enterprises, State Council, June 21, 1991, effective January 1, 1992.
10. Provisional Regulations Concerning Private Enterprises, promulgated by the State Council on June 25, 1988, effective July 1, 1988.
11. Provisional Regulations Concerning Income Tax on Private Enterprises, promulgated by the State Council on June 25, 1988, effective as of 1988.

12. Provisions Relating to the Imposition of Individual Income Regulatory Tax on Investors in Private Enterprises, promulgated by the State Council on June 25, 1988, effective as of 1988.
13. Implementing Measures for the Provisional Regulations Concerning Private Enterprises, effective February 1, 1989.
14. Implementing Rules on the Registration of State Trial Enterprise Groups, State Administration of Industry and Commerce (SAIC), State Commission for Restructuring The Economic System (SRC), State Planning Commission (SPC) and State Council Production Office, May 4, 1992.

B. Company Law

1. Measures [Regulations] on Enterprises' Shareholding System Experiment issued by SRC, SPC, Ministry of Finance (MOF), People's Bank of China (PBC) and State Council Production Office, May 15, 1992.
2. Views on Standards for Limited Share Companies, SRC, May 15, 1992.
3. Views on Standards for Limited Liability Companies, SRC, May 15, 1992.
4. Temporary Provisions on a Number of Issues Concerning Financial Management in Experimental Shareholding Enterprises, issued by MOF and SRC (Xinhua 6/27/92).
5. Accounting Regulations for Experimental Stock Enterprises, issued by MOF and SRC on May 23, 1992.
6. Trial Measures for the Registration and Administration of Property-Rights of State-Owned Assets, issued by the State Assets Management Bureau (SAMB), MOF and the State Administration for Industry and Commerce (SAIC) on May 11, 1992.
7. Temporary Provisions on Issues concerning Taxation of Experimental Shareholding Firms, issued by the State Taxation Bureau and SRC on June 12, 1992.
8. Interim Regulations governing labor and wages in enterprises experimenting with shareholding systems, issued by the Ministry of Labor and SRC on June 1, 1992.

9. Provisional Regulations on the Macro-control of Experimental Joint Stock Enterprises issued June 15, 1992 by the State Planning Commission and SRC.
10. Auditing Rules for Shareholding Enterprises, issued by the Audit Administration and SRC on June 29, 1992.
11. Interim Provisions on Administering the Land Assets of Experimental Shareholding Enterprises, issued by the State Land Administration Bureau and SRC on July 9, 1992.
12. Enterprise Accounting Principles, promulgated by the State Council, November 16, 1992, effective July 1, 1993.
13. General Principles on Financial Matters of Enterprises, promulgated by the State Council, November 16, 1992, effective July 1, 1993.
14. Interim Measures for Personnel Management of Enterprises Experimenting with the Shareholding System, promulgated on September 17, 1992 by the Ministry of Personnel and SRC.
15. Provisional Regulations of Shenzhen Municipality on Limited Share Companies, promulgated March 17, 1992.
16. Provisional Regulations of Shanghai Municipality on Limited Share Companies, promulgated May 18, 1992, effective June 1, 1992.

C. Bankruptcy and Competition Law

1. Law of the People's Republic of China on Enterprise Bankruptcy (for trial implementation), enacted by the Standing Committee of the National People's Congress, December 2, 1986, effective November 1, 1988 (three months after the State Enterprise Law).
2. Provisional Regulations on the Promotion and Protection of Socialist Competition, approved by the State Council, October 17, 1980
3. Regulations on Administration of Advertising, promulgated and announced by the State Council, November 10, 1987, effective December 1, 1987.
4. Administration of Advertising Regulations Implementing Rules, State Administration for Industry and Commerce, January 9, 1988.

D. Financial Law

1. Interim Regulations for the Control of Bonds by Enterprises promulgated by the State Council, March 27, 1987.
2. Measures of the Shanghai Municipality for Administration of the Trading of Securities, promulgated November 27, 1990, effective December 1, 1990.
3. Measures of Shanghai Municipality for Administration of Special Renminbi-denominated Shares, promulgated by PBC and Shanghai, November 22, 1991.
4. Detailed Implementing Rules for the Measures of Shanghai Municipality for Administration of Special Renminbi-denominated Shares, promulgated by PBC and Shanghai, November 25, 1991.
5. Provisional Measures of Shenzhen Municipality for Administration of the Issue and Trading of Shares, effective June 15, 1991.
6. Provisional Measures of Shenzhen Municipality for Administration of Special Renminbi-denominated Shares, promulgated by PBC and Shenzhen, December 16, 1991.
7. Detailed Implementing Rules for the Provisional Measures of Shenzhen Municipality for Administration of Special Renminbi-denominated Shares, promulgated by PBC and Shenzhen, December 16, 1991.
8. Provisional Rules of Shenzhen Municipality for Registration of Special Renminbi-denominated Shares, January 29, 1992.
9. Provisional Rules on the Regulation of Stock Issuance and Trading, State Council, April 23, 1993.

E. Land and Social Welfare Law

1. Law of the People's Republic of China on Land Management, adopted June 25, 1986, as amended on December 19, 1988, by the Standing Committee of the National People's Congress.
2. Implementation Regulations of the Land Administration Law of the People's Republic of China, enacted by the State Council January 4, 1991.
3. Interim Regulations on Urban Land Use Rights, issued by the State Council May 19, 1990.

4. Tentative Procedures on the Administration of Allocated Leaseholds, promulgated by the State Land Administration Bureau March 8, 1992.
5. Measures of Shanghai Municipality on the Transfer of Land Use Rights for Value, November 29, 1987.
6. Regulations on Land Administration in Special Economic Zones of Guangdong Province, May 22, 1991.
7. Detailed Implementation Rules of Shenzhen Special Economic Zone on Land Registration and the Issue of Certificates, March 8, 1992.
8. Provisional Regulations on the Recruitment of Workers by State Enterprises, promulgated by the State Council July 12, 1986, effective October 1, 1986.
9. Provisional Regulations Governing the Implementation of the Labor Contract System by State Enterprises, promulgated by the State Council July 12, 1986, effective October 1, 1986.
10. Provisional Regulations Governing the Dismissal of Undisciplined Staff and Workers of State Enterprises, promulgated by the State Council July 12, 1986, effective October 1, 1986.
11. Provisional Regulations Governing Unemployment Insurance for State Enterprises, promulgated by the State Council July 12, 1986, effective October 1, 1986. [- superseded from May 1, 1993]
12. Regulations on Unemployment Insurance for State Enterprise Employees, State Council, April 22, 1993, effective May 1, 1993.

F. Contract Law, Courts and Dispute Resolution

1. Economic Contract Law of the People's Republic of China, adopted by the National People's Congress December 13, 1981; effective May 1, 1982.
2. Regulations on Loan Contracts, issued by the State Council February 28, 1985.
3. Regulations on Economic Contract Arbitration, promulgated by the State Council, August 22, 1983.

4. General Principles of the Civil Code, adapted by the National People's Congress April 12, 1986; effective January 1, 1987.
5. Administrative Litigation Law, adapted by the National People's Congress, April 4, 1989, effective October 1, 1990.
6. Law of Civil Procedure of the People's Republic of China, adopted by the People's Congress, April 9, 1991.

Basic Forms of Shareholding Enterprises²

LIMITED	SHARE	COMPANIES	LIMITED LIABILITY COMPANIES
Incorporator Held	Fixed channel Fund Raising	Public Fund Raising	
SOURCES	OF	FUNDS	
can only raise funds from incorporators; large SOEs can use this form (7)	can raise funds from inc. + other legal persons + w/app. from co. employees No public share issuance (7)	raise funds from "society" in addition to inc. funds (7)	
can convert to public fund raising if increasing capital after 1 yr. w/app. (7)	can convert to public fund raising if increasing capital after 1 yr. w/app. (7)		
INCORPORATORS			
3 or more incorporators (9)	3 or more incorporators; large SOEs can be sole inc. w/app. (9)	3 or more incorporators; large SOEs can be sole inc. w/app. (9)	2-30 shareholders (w/app. up to 50) (9)
	inc. must hold at least 35% (8)	inc. must hold at least 35% (8)	
inc. must be PRC legal persons, excl. private ents. + wholly-owned foreign ents. (10)	inc. must be PRC legal persons, excl. private ents. + wholly-owned foreign ents. (10)	inc. must be PRC legal persons, excl. private ents. + wholly-owned foreign ents. (10)	
Sino-for. jt. ventures can't exceed 1/3 of incorporators (10)	Sino-for. jt. ventures can't exceed 1/3 of incorporators (10)	Sino-for. jt. ventures can't exceed 1/3 of incorporators (10)	
individuals can't be inc. (10)	individuals can't be inc. (10)	individuals can't be inc. (10)	
TRANSFERABILITY	OF	SHARES	

²See Measures on the Shareholding Enterprises Experiment (5/15/92) (M); Views on Standards for Limited Share Companies (5/15/92) (article number); (Views on Standards for Limited Liability Companies (article number).

transferable among legal persons (30-1)	transferable among legal persons + employees of co. only (30-1)		
inc. shares can't transfer w/in 1 yr. of estab. (30-4)	inc. shares can't transfer w/in 1 yr. of estab. (30-4)	inc. shares can't transfer w/in 1 yr. of estab. (30-4)	
	employee shares can't transfer w/in 3 yrs. of sale, unless leave or die (30-5)	employee shares can't transfer w/in 3 yrs. of sale, unless leave or die (30-5)	
SHARES			
4 types: state legal person individual for. investor (24)	4 types: state legal person individual for. investor (24)	4 types: state legal person individual for. investor (24)	govt. depts. auth. to rep. state; ent. legal persons, other legal persons, individuals (19)
state shares normally common (24-1)	state shares normally common. (24-1)	state shares normally common (24-1)	private cos. estab. by ind./private ent. legal persons follow priv. ent. regs (19)
if A co. holds >10% of B co., B can't buy shares in A (24-2)	if A co. holds >10% of B co., B can't buy shares in A (24-2)	if A co. holds >10% of B co., B can't buy shares in A (24-2)	scope + proportion of ind./priv. ent. legal person investment in non-priv. ent. acc. to regs (19)
individual can't hold >5% (excl foreign investors) (24-3)	individual can't hold >5% (excl foreign investors) (24-3)	individual can't hold >5% (excl foreign investors) (24-3)	
	employee shares can't exceed 20% (24-3)	employee shares can't exceed 10% of publicly issued shares (24-3)	
cos. permitted for. investors can issue B shares (29)	cos. permitted for. investors can issue B shares (29)	cos. permitted for. investors can issue B shares (29)	

for. investors can't buy A shares; others can't buy B shares (29)	for. investors can't buy A shares; others can't buy B shares (29)	for. investors can't buy A shares; others can't buy B shares (29)	
STOCK			
		publicly issued shares at least 25% (24-2)	
common stock + may issue preferred (23)	common stock + may issue preferred (23)	common stock + may issue preferred (23)	
		province measures and scale of stock issuance req. PBC + SRC app, balance by SPC, enter into state securities plan (M8)	
		outside of Shanghai + Shenzhen, need State Council Stock Listing Office app. (M8)	
		public issuance of stock requires PBC approval (18)	
share rights certificate issued (25)	share rights certificate issued (25)	stock issued (25)	
REGISTERED	CAPITAL		
reg. capital at least Y10,000,000; w/for. investor at least Y30,000,000 (12)	reg. capital at least Y10,000,000; w/for. investor at least Y30,000,000(12)	reg. capital at least Y10,000,000; w/for. investor at least Y30,000,000 (12)	minimum reg. capital: production operations-- Y500,000; commercial + wholesale goods/matls- Y500,000; retail commerce-- Y300,000; sci/tech dev., consulting, services-- Y100,000 (10)

not more than 20% intangible property (excl land use rts) (22)	not more than 20% intangible property (excl land use rts) (22)	not more than 20% intangible property (excl land use rts) (22)	at least 50% of minimum amount in cash (12)
--	--	--	---

Policy Research Working Paper Series

Title	Author	Date	Contact for paper
WPS1178 Productivity of Public Spending, Sectoral Allocation Choices, and Economic Growth	John Baffes Anwar Shah	September 1993	C. Jones 37699
WPS1179 How the Market Transition Affected Export Performance in the Central European Economies	Bartłomiej Kaminski	September 1993	P. Kokila 33716
WPS1180 The Financing and Taxation of U.S. Direct Investment Abroad	Harry Huizinga	September 1993	R. Vo 31047
WPS1181 Reforming Health Care: A Case for Stay-Well Health Insurance	Zeljko Bogetic Dennis Heffley	September 1993	F. Smith 36072
WPS1182 Corporate Governance in Central and Eastern Europe: Lessons from Advanced Market Economies	Cheryl W. Gray Rebecca J. Hanson	September 1993	M. Berg 31450
WPS1183 Who Would Vote for Inflation in Brazil? An Integrated Framework Approach to Inflation and Income Distribution	Cheikh Kane Jacques Morisset	September 1993	T. Hollestelle 30968
WPS1184 Providing Social Benefits in Russia: Redefining the Roles of Firms and and Government	Simon Commander Richard Jackman	September 1993	O. del Cid 35195
WPS1185 Reforming Hungarian Agricultural Trade Policy: A Quantitative Evaluation	Morris E. Morkre David G. Tarr	September 1993	N. Artis 37947
WPS1186 Recent Estimates of Capital Flight	Stijn Claessens David Naudé	September 1993	R. Vo 31047
WPS1187 How Should Sovereign Debtors Restructure Their Debts? Fixed Interest Rates, Flexible Interest Rates, or Inflation-indexed	Andrew Warner	September 1993	J. Queen 33740
WPS1188 Developmentalism, Socialism, and Free Market Reform: Three Decades of Income Distribution in Chile	Mario Marcel Andrés Solimano	September 1993	S. Florez 39075
WPS1189 Can Communist Economies Transform Incrementally? China's Experience	Alan Gelb Gary Jefferson Inderjit Singh	September 1993	PRDTM 37471
WPS1190 The Government's Role in Japanese and Korean Credit Markets: A New Institutional Economics Perspective	Yoon Je Cho Thomas Hellmann	September 1993	T. Ishibe 37665

Policy Research Working Paper Series

	Title	Author	Date	Contact for paper
WPS1191	Rent-Sharing in the Multi-Fibre Arrangement: The Case of Mexico	Geoffrey J. Bannister	September 1993	A. Daruwala 33713
WPS1192	Effects of Tax Reform on Argentina's Revenues	Jacques Morisset Alejandro Izquierdo	September 1993	G. Carter 30603
WPS1193	The Armenian Labor Market in Transition: Issues and Options	Milan Vodopivec Wayne Vroman	September 1993	S. Florez 39075
WPS1194	How Fast Has Chinese Industry Grown?	Tom Rawski	September 1993	E. Khinc 37471
WPS1195	The Enterprise Sector and Emergence of the Polish Fiscal Crisis, 1990-91	Mark Schaffer	September 1993	E. Khine 37471
WPS1196	Corporate Tax Structure and Production	Jeffrey Bernstein Anwar Shah	September 1993	C. Jones 37699
WPS1197	Determinants of Inflation among Franc Zone Countries in Africa	Bruno Boccara Shantayanan Devarajan	September 1993	C. Jones 37699
WPS1198	Enterprise Reform in China: The Evolving Legal Framework	Natalie Lichtenstein	September 1993	M. Rangarajan 81710