

THE LAW AND POLICY OF STATE ENTERPRISES IN POST-MAO CHINA

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ABSTRACT

This research is aimed at analyzing the legal aspects of state enterprise reform in the People's Republic of China. It attempts not only to explain relevant laws and regulations in the context of China's complex economic, social and political environments, but also to reveal the basic nature and the practice of these laws and regulations.

Since the late 1970s, considerable efforts have been made by the Chinese authorities to use formal laws and regulations to adjust different and often conflicting interests emerging in the course of the programme of reforms, and, in particular, to reshape and protect the rights and interests of state enterprises. Among the most noteworthy of the efforts at state enterprise reform are the official conferment of legal personality and management rights to state enterprises, the establishment of a director responsibility system, the adoption of a bankruptcy law, and employment of the contracting system for settling the government -- enterprise relationship. These attempts have had some effect, and state enterprises have gained the capacity to act as independent legal entities. Furthermore, state enterprises, in some places and from time to time, have come to possess a certain degree of autonomy which was impossible prior to the reforms.

Nevertheless, these efforts have not been as effective and authoritative as they were designed and expected to be. Many enacted laws and regulations have not been followed in practice. Indeed, in many respects, they are readily undermined or even completely disregarded.

The relevant laws and regulations are strongly policy-oriented. Being the mere embodiment of state policies, they can be easily undermined as a result of policy changes. The ineffective application of many laws and regulations is due less to the defects in their legal and technical provisions than to the ambiguity and uncertainty of the policies underlying state enterprise reform.

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FOREWORD

As a Chinese law graduate studying abroad, I am one of the many beneficiaries of the policies of reform and opening to the outside world. In undertaking research on the legal aspects of state enterprise reform, I attempt to explore the interaction of the law and the reform process -- two of the most appealing phenomena in the post-Mao era. I hope that this research is not only useful to the further understanding of Chinese state enterprises, but also helpful to the general comprehension of the role of the law in economic reforms.

My interest in doing this research springs from a number of considerations. It originated in my unfinished LLM studies of civil and economic law at the Graduate School of the Chinese Academy of Social Sciences in Beijing. This became more developed during my study of Company Law while taking a LLM at Queen Mary College, London University. But more importantly, I have long believed that in furthering its economic reforms, China is in need of a company law. I also believe that only after successful reform in state enterprises will a comprehensive company law become possible and meaningful in China. There is no doubt in my mind that such a company law has to develop from the existing legal framework governing state enterprises. Therefore, before understanding or even talking about a company law for China, detailed, technical and comparative research into the existing legal regulation of Chinese state enterprises is necessary as a first step. Such research, in my view, is a duty for persons like myself, who have studied both in China and in the West.

The scholarship which I have held for the last four years has enabled me to complete this study in time. I must, therefore, take this opportunity to express my sincere thanks to the Chinese government and the British Council, both of which have provided this scholarship. I would also like to thank the Central Research Fund of London University for providing generous support for my study visit to China.

I am grateful to Michael Palmer for his supervision and support throughout this research. Without his thoughtful instructions and great patience, this thesis would have hardly been possible. My thanks are also due to Yuan Cheng who has offered very valuable help to my research and writing.

I dedicate this thesis to my mother who died sadly soon after I was enrolled as a first-year student at a Chinese primary school, and to my father who, despite his suffering loneliness and poor health at home, has continuously shown a helpful and precious encouragement to my studies in London.

Finally, the laws and regulations cited in this thesis are as they stand on July 31, 1992.

TABLE A: Abbreviations

I. Organisations

abbres.	full English translations
ABIC	Administrative Bureau for Industry and Commerce
ALL	Administrative Litigation Law
CCP	Chinese Communist Party
GAC	Government Administration Council
NPC	National People's Congress
SABIC	State Administrative Bureau for Industry and Commerce
WSC	Worker -- Staff Congress

II. Major Laws

abbres.	full English translations
EBL	Enterprise Bankruptcy Law
ECL	Economic Contract Law
GPCL	General Principles of Civil Law
SEL	State Enterprise Law

III. Journals and Newspapers in Chinese

abbres.	Chinese <u>pinyin</u>	English translations
<u>BJRB</u>	<u>Beijing Ribao</u>	Beijing Daily (Beijing)
<u>FX</u>	<u>Faxue</u>	Law Science Monthly (Shanghai)
<u>FXPL</u>	<u>Faxue Pinglun</u>	Law Review (Wuhan)
<u>FXJK</u>	<u>Faxue Jikan</u>	Law Science Quarterly (Chongqing)

<u>FXYJ</u>	<u>Faxue Yanjiu</u>	Studies in Law (Beijing)
<u>FXZZ</u>	<u>Faxue Zazhi</u>	Law Journal (Beijing)
<u>FZJS</u>	<u>Fazhi Jianshe</u>	Legal Construction (Beijing)
<u>FZRB</u>	<u>Fazhi Ribao</u>	Legal Daily (Beijing)
<u>GMRB</u>	<u>Guangming Ribao</u>	Enlightenment Daily (Beijing)
<u>GRRB</u>	<u>Gongren Ribao</u>	Workers' Daily (Beijing)
<u>JJF</u>	<u>Jingji Fa</u>	Economic Law (Beijing)
<u>JJGL</u>	<u>Jingji Guanli</u>	Economic Administration (Beijing)
<u>JJRB</u>	<u>Jingji Ribao</u>	Economic Daily (Beijing)
<u>JJYF</u>	<u>Jingji Yu Fa</u>	Economy and Law (Beijing)
<u>JJYFZ</u>	<u>Jingji Yu Fazhi</u>	Economy and Law (Shengyang)
<u>MZYFZ</u>	<u>Minzhu Yu Fazhi</u>	Democracy and Legal System (Shanghai)
<u>RMRB</u>	<u>Renmin Ribao</u>	Peoples' Daily (Beijing)
<u>XHYB</u>	<u>Xinhua Yuebao</u>	Xinhua Monthly (Beijing)
<u>ZFLT</u>	<u>Zhengfa Luntan</u>	Tribune of Political Science and Law (Beijing)
<u>ZGFX</u>	<u>Zhongguo Faxue</u>	Laws in China (Beijing)
<u>ZGFZB</u>	<u>Zhongguo Fazhibao</u>	China Legal News (Beijing)
<u>ZGJJTZGG</u>	<u>Zhongguo Jingji Tizhi Gaige</u>	China's Economic System Reform (Beijing)

III. Publications in English

<u>BBC SWB</u>	<u>British Broadcasting Corporation, Summary of World Broadcasts</u> (London)
<u>FBIS (CHI)</u>	<u>Foreign Broadcast Information Service (Daily Report, China)</u> (Washington)

IV. Collection of Legal Documents in Chinese

English Citation	Chinese <u>Pinyin</u>
Bulletin of the NPCSC	<u>Zhonghua Renmin Gongheguo Quanguo Renmin Daibiao Dahui</u>

Changwu Weiyuanhui Gongbao
(Series, Beijing)

Bulletin of the State Council

Zhonghua Renmin Gongheguo
Guowuyuan Gongbao (Series,
Beijing)

Bulletin of the Supreme People's Court

Zhonghua Renmin Gongheguo
Zuigao Renmin Fayuan Gongbao
(Series, Beijing)

Collection of Company Laws and Regulations

Zhonghua Renmin Gongheguo Gongs
Faui Huibian (Law Press,
Beijing, 1991)

Laws and Regulations of the PRC

Zhonghua Renmin Gongheguo
Faui Huibian (Series, Law
Press, Beijing)

Laws and Regulations of the PRC Central Government (1949-1950)

Zhonghua Renmin Gongheguo
Zhongyang Renmin Zhengfu Faling
Huibian (Law Press, Beijing,
1980)

Selected Enterprise Laws and Regulations

Zhonghua Renmin Gongheguo
Qiye Faui Xuanbian (Law Press,
Beijing, 1981)

TABLE B: Laws, Regulations and Standard Legal Documents

Administrative Litigation Law (ALL)

adopted on April 4, 1989
effective from October 1, 1990

Civil Procedure Law (For Trial Implementation)

adopted on March 8, 1982
effective from October 1, 1982

Civil Procedure Law

adopted on and effective from
April 9, 1991

Economic Contract Law (ECL)

adopted on December 13, 1981
effective from July 1, 1982

Enterprise Bankruptcy Law (EBL)

adopted and promulgated on
December 2, 1986
effective from November 1, 1988

General Principles of Civil Law (GPCL)

adopted on April 12, 1986
effective from January 1, 1987

Implementing Rules Concerning the Law on Wholly Foreign Owned Enterprises

promulgated on and effective
from December 12, 1990

Implementing Regulations Concerning the Law on Sino-Foreign Equity Joint Ventures

promulgated on and effective
from September 20, 1983

Implementing Measures on Provisional Regulations Concerning Private Enterprises

promulgated on January 16, 1989
effective from February 1, 1989

Implementing Regulations Concerning the Provisional

Regulations on Private Enterprises

adopted on March 30, 1951

Implementing Regulations on the Regulations Concerning the Administration of Registration of Enterprise Legal Persons

promulgated on November 3, 1988

effective from December 1, 1988

Law on Sino-Foreign Cooperative Joint Ventures

adopted on April 13, 1988

effective from April 13, 1988

Law on Sino-Foreign Equity Joint Ventures

adopted on and effective from
July 1, 1979

amended on April 4, 1990

Law on Wholly Foreign Owned Enterprises

adopted on April 12, 1986

effective from April 12, 1986

Provisional Regulations Concerning Private Enterprises (1988)

adopted on June 3, 1988

effective from July 1, 1988

Provisional Regulations Concerning the Contracting Management Responsibility System in State Industrial Enterprises

promulgated on February 27, 1988

effective from March 1, 1988

Provisional Regulations Concerning the Work of Directors in State Industrial Enterprises

promulgated on and effective
from January 2, 1982

Provisional Regulations Concerning the Worker -- Staff Congress in State Industrial Enterprises

promulgated on September 15,
1986, effective from October 1,
1986

Provisional Regulations Concerning the Work of Grassroots Party Organisations in State Industrial Enterprises

promulgated on September 15,
1986

effective from October 1, 1986

Provisional Regulations Concerning the Work of Directors in State Industrial Enterprises

promulgated on September 15, 1986, effective from October 1, 1986

Provisional Regulations Concerning State Industrial Enterprises

promulgated on and effective from April 1, 1983

Provisional Regulations on State-Private Industrial Enterprises

adopted on September 2, 1954

Provisional Regulations on Private Enterprises

adopted on December 29, 1950

Provisional Regulations on Worker -- Staff Congress in State Industrial Enterprises

promulgated on and effective from July 13, 1981

Regulations Concerning Collective Enterprises in Cities and Towns

promulgated on September 9, 1991 effective from January 1, 1992

Regulations Concerning Collective Enterprises in Rural Areas

adopted on May 11, 1990 effective from July 1, 1990

Regulations Concerning the Administration of Registration of Enterprise Legal Persons

promulgated on June 3, 1988 effective from July 1, 1988

Regulations Concerning the Administration of Soviet State-Owned Factories

promulgated on and effective from April 10, 1934

Regulations Concerning the Work of State Industrial Enterprises (Draft)

promulgated on and effective from September 16, 1961

**Regulations for the Trnasformation of the Management Mechanism
of State Industrial Enterprises**

promulgated on and effective
from July 23, 1992

Standard Opinions Concerning Companies Limited by Shares

promulgated on and effective
from May 15, 1992

Standard Opinions Concerning Limited Liability Companies

promulgated on and effective
from May 15, 1992

**Working Regulations Concerning State Industrial Enterprises
(Draft)**

promulgated and effective from
September 16, 1961

State Enterprise Law (SEL)

adopted on April 13, 1988
effective from August 1, 1988

CHAPTER ONE

INTRODUCTION

I. Aim and Structure of the Research

A. Chinese economic reforms and the law

Since 1979, the People's Republic of China (PRC) has attempted to reconstruct many aspects of its economy. The reform of state enterprises, which began to be introduced as early as 1979 and was formally commenced nationwide in 1984, has been generally regarded as the most difficult and most fascinating part of the economic reforms as a whole.¹ This is mainly because state enterprises are the dominant form of business organisation in the PRC, and occupy the most important position in the Chinese national economy. The significance and complexity of state enterprise reform lies not only in its enormous economic implications, but also in the profound social and political changes that it is likely to introduce.²

¹ For a general assessment of Chinese economic reforms, see Lin Wei and Arnold Chao (ed.), China's Economic Reforms, University of Pennsylvania Press (Philadelphia) 1982; see also Bruce L. Reynolds (ed.), Reform in China: Challenges and Choices, M.E. Sharpe, Inc. (Armonk, New York / London) 1987. For a specific discussion of enterprise reform, see, for example, Gene Tidrick and Chen Jiyuan (ed.), China's Industrial Reform, Oxford University Press 1987. To a significant extent, many parts of urban economic reforms, including planning, pricing, banking, taxation, social security, and housing, are either directly or indirectly connected with state enterprise reform.

² The political significance of Chinese state enterprise reform has become more obvious since the collapse of the Soviet socialist regime in 1991. Chinese authorities and many Chinese scholars consider that one of the most fundamental reasons for the collapse of the soviet empire was the weakness

Moreover, many aspects of the reform concerning state enterprises are pioneering efforts when viewed in the general context of the on-going economic reforms. Property ownership is one aspect which was proved extremely controversial and has yet to be properly addressed by the Chinese authorities.

The most fundamental aim of state enterprise reform, as conceived by the Chinese leadership, is to "invigorate" (gaohuo) enterprises. According to this general policy, while the rights and interests of the state in state enterprises must be preserved, attempts should be made to give such enterprises relative autonomy, that is, an appropriate degree of independence and protection from excessive and malign government intervention.

According to Chinese official views, in pursuing state enterprise reform, and indeed economic reforms as a whole, not only administrative and economic methods but also legal mechanisms should be employed to regulate and adjust the various interests involved in and affected by the reforms. The deliberate combination of these three methods constitutes a striking contrast with the PRC practice for many years prior to the late 1970s when administrative instructions and orders were almost exclusively relied on by the government to run state enterprises. Nevertheless, the relative importance of each of these three methods, in terms of the attention paid to them by the Chinese leadership, is not easy to ascertain. While the role of economic levers, including taxation, pricing and credit, has recently been given more attention, Chinese authorities from time to time still tend to resort to old administrative measures to cope with complicated problems.

The growing importance of the law in China's economic

of the state sector of the Soviet economy. Therefore, since late 1991, the Chinese government has renewed its commitment and, indeed attached more attention, to the need for the reform of large and medium-sized state enterprises. It also increasingly recognises the political significance of such reform. For a report on the special conference on "making a good job of" large and medium-sized state enterprises, organised by the CCP Central Committee in September 1991, see RMRB, Sept.28, 1991, p.1.

reforms is widely acknowledged.³ Indeed, the unprecedented willingness of the Chinese leadership to build an appropriate legal system to serve China's drive for modernisation has been repaid with the many volumes of laws and regulations adopted since 1979. Moreover, despite the unfortunate disruption caused by the events of June 1989, the trend to enact more laws and regulations to govern various aspects of the society has continued, and is very likely to continue in the future.

As far as state enterprises are concerned, in addition to the General Principles of Civil Law (GPCL) of 1986,⁴ the most significant legislation is the State Enterprise Law (SEL) which was adopted by the National People's Congress on April 13, 1988 and in force on August 1, 1988. This law, the "overall spirit" of which was characterized by one observer as "consistent with economic progress",⁵ was the first major law to be adopted in the PRC for the formal regulation of state enterprises. In addition, several other aspects of state enterprise reform have also been put under systematic legal regulation. For example, the Provisional Regulations

³ For a discussion of the developments of Chinese law in the early 1980s, see Stanley Lubman, "Emerging Functions of Formal Legal Institutions in China's Modernisation", China Law Reporter, Fall 1983, pp.195-266; Richard Baum, "Modernisation and Legal Reform in Post-Mao China: The Rebirth of Socialist Legality", Studies in Comparative Communism, Summer 1986, pp.69-103.

For a later observation, see Walter Gellhorn, "China's Quest for Legal Modernity", Journal of Chinese Law, Vol.1, No.1, Spring 1987, pp.1-22. For a comprehensive review of the achievements and problems until 1989, see Anthony Dicks, "The Chinese Legal System: Reforms in Balance", The China Quarterly, No.116, September 1989, pp.540-76.

⁴ Adopted at the Fourth Session of the Sixth National People's Congress on Apr.12, 1986 and effective as from Jan.1, 1987. For an assessment of this important legislation, see Henry Zheng, "China's New Civil Law", American Journal of Comparative Law, Vol.34, 1986, pp.669-704.

⁵ James Feinerman, "The Evolving Chinese Enterprise", Syracuse Journal of International Law and Commerce, Winter 1989, pp.203-14, at p.214. "The New State Enterprise Law: China Takes A Step Towards Comprehensive Corporate Law", East Asian Executive Reports, June 1988, pp.9-11.

Concerning the Contracting System of State Industrial Enterprises were promulgated by the State Council in 1988. In spite of many ambiguities and uncertainties,⁶ these Regulations represent a major step towards imposing legal control over the contracting system implemented in the overwhelming majority of Chinese large and medium-sized state enterprises.

B. Existing literature and problems

Since the early 1980s, the reform of state enterprises has attracted extensive attention from both Chinese and foreign observers. Much research has been conducted in order to evaluate the manner in which this reform has proceeded. This research reflects the views and concerns of relevant scholars in their attempts to examine the achievements and objective problems of China's enterprise reform. Although this literature is quite extensive, in my view, the overall regulation of Chinese state enterprises has yet to receive the kind and degree of attention that would lead to penetrating and accurate insight into the most important legal aspects of state enterprise reform.

First, existing Western analyses do not provide a comprehensive view of the legal regulation of Chinese state enterprises. In the West, much of the writing on Chinese state enterprise reform has concentrated on the analysis of economic, political and social aspects of the reform. It has neglected the legal dimension of state enterprise reform, and indeed economic reforms as a whole.⁷ While economic, political and social analyses are very important in that they may provide basic explanations of various problems to be tackled

⁶ See the discussion below in Chapter Eight.

⁷ For a critical summary of the inadequate attention paid by Western scholars in the legal aspects of China's reforms, see Stanley Lubman, "Studying Chinese Law: Limits, Possibilities and Strategy", American Journal of Comparative Law, Vol.39, No.2, 1991, pp.293-341, at 339.

or being brought about by the ongoing reform, the legal implications of, and the efforts through law to address, these problems need to be examined in an accurate and scholarly manner. For example, the concept of "property right" (caichanquan) is not viewed in the same way by economists and lawyers. Economists tend to be interested in analyzing the economic profits arising from the operation of the property. It follows that it may make little difference whether or not enterprises actually own the property, so long as the property can be used to make profits. In contrast, lawyers are more specific and accurate in that they have to define the precise legal nature of the property rights. This is because the concrete nature of proprietorial rights varies from full "ownership" to mere "management", from operating by "contracting" to operating by "leasing". As a result, a detailed and interesting account of the property rights of Chinese state enterprises,⁸ may offer little help for understanding the problem from the legal point of view. An examination from economic and political viewpoints of the changing relationship between the directors and party secretaries in state enterprise reform highlights the complexity of this issue.⁹ But such analyses may well fail to address the problems involved because they may not reveal the difficulties in making the legal provisions of the SEL. They may also fail to distinguish the effects of legal provisions as opposed to other factors, such as political, social and ideological considerations. Obviously, these problems must be examined from a legal point of view in order to achieve a comprehensive and essential understanding of state enterprise reform.

⁸ See, for example, David Granik, Chinese State Enterprise, University of Chicago Press (Chicago and London) 1990. This research, which was mainly based on the data collected in the early and mid 1980s, reflects the view of an economist on Chinese enterprise reform.

⁹ See Heath B. Chamberlain, "Party Management Relations in Chinese Industries: Some Political Dimensions of Economic Reform", The China Quarterly, No.112, 1987, pp.631-61.

There have been, of course, several attempts to analyze legal aspects of Chinese state enterprise reform. These are represented by the publication in English of a number of articles written by both Western and Chinese writers. Generally speaking, property rights¹⁰ and bankruptcy rules¹¹ have received the most attention. In addition, the legal person system,¹² and taxation system¹³ have also been discussed to a limited extent. However, these studies are concerned only with isolated features of the legal regulation of Chinese state enterprises. Many other fundamental aspects of the reform have thus been neglected. For example, at the time of writing, I am not aware of any specific discussion on the question of the legal guarantee of enterprise autonomy, although this is clearly one of the most important subjects in the legal analysis of state enterprise reform. Furthermore,

¹⁰ See, for example, Howard Chao and Yang Xiaoping, "The Reform of the Chinese System of Enterpriser Ownership", Stanford Journal of International Law, Vol.23, 1987, pp.365-97; Wang Liming and Liu Zhaonian, "On the Property Rights System of the State Enterprises in China", Law and Contemporary Problems, Vol.52, 1989, pp.19-42; Edward Epstein, "The Theoretical System of Property Rights in China's General Principles of Civil Law: Theoretical Controversy in the Drafting Process and Beyond", Law and Contemporary Problems, Vol.52, 1989, pp.177-216; Paul Cantor and James Kraus, "Changing Patterns of Ownership Rights in the People's Republic of China: A Legal and Economic Analysis in the Context of Economic Reforms and Social Conditions", Vanderbilt Journal of Transnational Law, Vol.23, 1990, pp.479-538.

¹¹ See, for example, Henry R. Zheng, "Bankruptcy Law of the People's Republic of China -- Principle, Procedure and Practice", Vanderbilt Journal of Transnational Law, Vol.19, 1986, pp.683-732; Ta-Kuang Chang, "The Making of the Chinese Bankruptcy Law: A Study in the Chinese Legislative Process", Harvard International Law Journal, Vol.28, 1987, pp.333-72; M. Minor and K. Steven-Minor, "China's Emerging Bankruptcy Law", International Lawyer, 1988, pp.1217-26.

¹² See, for example, Zhao Zhongfu, "Enterprise Legal Persons: Their Important Status in Chinese Civil Law", Law and Contemporary Problems, Vol.52, 1989, pp.1-18.

¹³ See Yang Xiaoping, "Progress and Problems in the Development of a New Income Tax System for State-Owned Enterprises in China", in Journal of Chinese Law, Vol.3, Summer No.1 1989, pp.95-115.

the legal status of enterprise directors, which was the most central issue in enacting the SEL, has been much complicated by its historical, political, and ideological factors. But this topic has not been examined by Western observers from the legal standpoint. In addition, many practical aspects of state enterprise reform, such as the contracting system, need to be carefully examined in order to consider the practical implementation of enterprise autonomy policy.

Since the late 1980s, there have also been a number of English-language accounts of legal and economic reforms in China. As far as the SEL is concerned, James Feinerman in particular has provided several discussions of this law.¹⁴ His comments serve as a good introduction to the SEL, but are more explanatory than analytical. A general and brief introduction of the SEL such as Feinerman's provides only a bird's-eye view of the main issues involving state enterprise reform. But it cannot offer a thorough investigation into this complicated matter.¹⁵

Interesting and useful research on legal institutions and economic reforms in China has been carried out by Donald Clarke.¹⁶ However, his main concerns appear to be the issues relating to legal rules and relevant institutional design. While the formulation and implementation of legal rules were examined and a study of some particular rules is provided by Clarke's writing, he mainly focuses on relevant institutions, including law-making bodies, government departments, and the judicial system. His analysis is primarily concerned with

¹⁴ See Feinerman, supra note 5; Feinerman, "The New State Enterprise Law: China Takes A Step Towards Comprehensive Corporate Law", East Asian Executive Reports, June 1988, pp.9-11.

¹⁵ This is also a main problem in his latest attempt to analyze China's economic reforms. See James Feinerman, "Economic and Legal Reform in China, 1978-1991", Problems of Communism, Sept-Oct 1991, pp.62-75.

¹⁶ Donald Clarke, "What's Law Got to Do with It? Legal Institutions and Economic Reform in China", UCLA Pacific Basin Law Journal, Vol.10, No.1, Fall 1991, pp.1-76.

state enterprise reform, but does not approach the issue from the standpoint of company or corporation law. As a result, readers are left without a full and clear understanding of either the legal status of state enterprises under contemporary Chinese law or the various efforts which have been made to place state enterprises within a proper legal framework. Inadequate examination of state enterprises per se may make it more difficult to fully account for the decisive reasons behind the failure of the institutional design and legal efforts regarding state enterprises. This is partly due to the chronic and widespread lack of judicial independence, which affects many legal subjects -- not state enterprises in particular. In fact, failure to realise state enterprise autonomy can only be understood by reference to the special status of state enterprises and their relations with government departments. In addition, Clarke discusses only selected aspects of the legal rules and institutions relating to state enterprises. Therefore, many fundamental aspects of the legal regulation of state enterprise reform remain unexamined.

In my view, although general discussion of institutional aspects of economic and legal reforms is valuable, it is the process of the law-making and the achievements, as well as defects, existing in the enacted laws and regulations, that should be the focus of careful study in the case of state enterprise reform. More specifically, key issues for consideration include the response of the law to the needs of enterprise reform, the ways in which the laws and regulations have been formulated, the personality and property rights that have been granted to state enterprises, and the degree of autonomy that is guaranteed by law and implemented in practice. Clearly, in order to answer these questions, many internal issues concerning state enterprises must be analyzed. In other words, it is necessary to pay close attention to the internal functioning components and institutions of state enterprises, as well as their outside relations with other entities.

Secondly, existing research contributed by Chinese lawyers on state enterprise reform has been inadequate. It is true that, with the increasing emphasis on the role of law in contemporary China, Chinese legal scholars have engaged in extensive discussions concerning various issues in state enterprise reform. These discussions reached a peak in the mid 1980s -- in particular, immediately after the promulgation of the SEL in 1988. A considerable number of books and articles were published.¹⁷ However, many of these discussions are explanatory, rather than analytical in nature. Many Chinese writers are only interested in providing answers to questions raised by the written law and neglect analysis of the often complex social, economic and political issues underlying these questions and answers. Furthermore, many scholars in China tend to praise the current treatment of state enterprise reform; they do not attempt to criticize and make suggestions concerning possible improvement.

One of the most obvious examples is the "right of management" (jingyingquan) accorded by both the GPCL and the SEL to state enterprises. As will be shown in many chapters of this thesis, the concept of management right -- which is no more than a compromise between radical and conservative reformers -- has failed to grant state enterprises the very

¹⁷ See, for example, Wang Zongfei and others, Gongye Qiyefa Wenda (Questions and Answers Concerning the SEL), China Agricultural Machinery Press (Beijing) 1988; Economic Legislation Bureau under the State Economic Commission, Qiyefa Jianghua (Explanations Concerning the SEL), Enterprise Management Press (Beijing) 1988; Song Haobo and Liu Yanli, Gongye Qiyefa Gailun (Introduction to the SEL), China Goods and Materials Press (Beijing) 1988; Editorial Group, Quanmin Suoyouzhi Gongye Qiyefa Jiangzuo (Lectures on the SEL), Machinery and Industry Press (Beijing). Also see Wang Baoshu, "Lun Quanmin Suoyouzhi Gongye Qiyefa Zai Qiye Lifa Shang de Tupo" (On the Breakthroughs of the SEL in Enterprise Legislation), ZGFX, No.4, 1988, pp.3-10; Wang Baoshu, "Lun Quanmin Suoyouzhi Gongye Qiyefa Xingzhi" (On the Nature of the SEL), FXZZ, No.2, 1988, pp.12-4; Ma Junju and Yu Yanman, "Suoyouquan he Jingyingquan Fengli Shi Qiyefa de Linghun" (The Separation of the Ownership from the Management is the Soul of the SEL), FXPL, No.3, 1988, pp.1-5. Similarly, the promulgation in 1986 of the EBL was also followed by a number of publications explaining this law as it stands in text.

kind of independence and autonomy needed for efficient management and real responsibility.

An additional shortcoming of legal research within China on state enterprises is that there has been little discussion, from the legal standpoint, of problems resulting from the actual implementation of the SEL.¹⁸ Although complaints about the failure to guarantee autonomy for state enterprises are popular in many walks of Chinese society -- including lawyers and economists -- Chinese lawyers have conducted little research into the defects of the legal framework governing state enterprises. This is but one reflection of the essentially passive role played by Chinese lawyers in efforts to protect state enterprises from government intervention.

Thirdly, and most critically, both inside and outside China, research into the legal regulation of state enterprises has failed to pay sufficient attention to the complicated interaction between law and policy. As will be demonstrated in many chapters of this thesis, the promulgation of a number of formal laws and regulations does not mean that the law itself has always been explicit. Failure to place written laws and regulations in a broader policy spectrum leads to inaccurate and partial interpretation of these laws and regulations. This is particularly so in the case of state enterprises which possess very complex social, political as well as economic features. Many Chinese lawyers tend to either disregard or underestimate various policy considerations underlying legal provisions and provide an idealised and highly theoretical account of the laws and regulations being examined. Relevant chapters of this thesis will attempt to show that the legal person concept, and the contracting system, and worker's participation in enterprise management are all examples of such idealisations and overpraise.

In examining the laws and regulations concerning Chinese

¹⁸ There are a few exceptions. See, for example, Luo Mingda and Bian Xiangping, "Lun Qiyefa Shishi Zhong de Ruogan Wenti Jiqi Duice" (On the Several Problems and Countermeasures in the Implementation of the SEL), FXPL, No.5, 1989, pp.8-14.

state enterprises, some Western observers also fail to take into account the historical, political, social, and economic realities and considerations underlying the nominal legal provisions. This is so in the case of the PRC Enterprise Bankruptcy Law. As shown in Chapter Eight, some of the published papers on this subject simply attempt to "interpret" the law as it stands, and fail to analyze the factors underlying the Law's various provisions. Nor have such discussions fully explained the subsequent failure to enforce the Law.

Just as the making of Chinese law is generally believed to be strongly policy-oriented, so the implementation of the law is strongly influenced by government policies. The latter are unstable and often contradictory. In the end, written laws and regulations have to be viewed in light of the many complicated social, political and economic conditions which underline the law. The functions of the law are therefore restrained by government administrative measures and policies which maintain a significant role in controlling state enterprises.

In particular, in view of the strong tradition of policy domination of enterprises in the PRC prior to economic reforms, it is particularly necessary to study both the ways through which policies are transformed into law and the effects of the law vis-a-vis subsequent policy changes. Only after detailed examination of the dynamic interaction between the law and policy may research on state enterprise reform be carried out thoroughly.

C. Aim and methodology

Basically, the legal regulation of Chinese state enterprises can be approached with two main questions in mind. First, is it practical to employ laws and regulations to govern state enterprises? Secondly, are written laws and regulations effective?

These two questions may, however, be examined as two

closely related issues that depend not only on each other but also on many other common factors. The first of these additional common factors is that, for most of the period between the 1950s and the late 1970s, law was ignored in the PRC. It follows that considerable difficulties may almost inevitably complicate proposed legal regulation of any particular area of Chinese society. Secondly, the current economic reforms are far from settled in many aspects. This uncertainty casts serious doubt on the formulation as well as the implementation of the law. This is especially the case in laws governing state enterprises, which have proved to be the most controversial sector in the entire corpus of post-Mao economic reforms.

Given these common factors and potential obstacles to progress, the interdependence of the practicability and the effectiveness of legal regulation of state enterprises is more or less apparent. If the laws adopt a down-to-earth approach in an attempt to solve specific problems, and if sufficient account is taken of the social, economic and political environment in which state enterprises are operating, then written laws are more likely to be applied effectively. Otherwise, they will be meaningless.

When commenting on research into Chinese law, Professor Jean Escarra pointed out in the 1920s that four methods might be used. They are: observation, building the technical structure of an institution, history, and comparative jurisprudence.¹⁹ If the classification of these four methods is to be applied here, then this research is mainly conducted as an investigation into "building the technical structure of an institution". In the present study, by "institution" is meant the laws governing Chinese state enterprises -- though the concept of "institution" is also used to refer to concrete

¹⁹ See "Western Methods of Research into Chinese Law", in The Chinese Social and Political Science Review, Vol.VIII, Jan.1924. Cited in Yang Honglie, Zhongguo Falü Fada Shi (Development History of Chinese Law), Commercial Press (Nanjing) 1930, p.13. Professor Escarra was a legal advisor to the then Chinese Republican Government.

systems established within state enterprises, such as the director responsibility system and the worker -- staff congress.

Research into a legal institution may suffer, however, if insufficient attention is paid to the complex social, economic and political environment which may not only shape the law but also determine the functions of law. As Stanley Lubman²⁰ has rightly pointed out, the search for the functions of legal concepts and legal institutions in a broader social context should be the essential strategy for the study of Chinese law. Nevertheless, in the search policies play a key role, albeit sometimes "behind the scenes". To a significant extent, policy factors which underline legal provisions should be regarded as the decisive criteria for assessing the success or failure of the establishment of relevant legal concepts and legal institutions, even though these policy factors may not always be explicitly recorded.

This research is mainly concerned with state enterprises in the PRC. Nevertheless, I will analyze a number of issues comparatively. In addition to the analyses of different legal treatments regarding different types of enterprises operating in contemporary China, attention is also paid to the comparisons at two other levels: one is to compare the Chinese situations with the past experiences of the socialist Soviet Union and Eastern Europe; the other is to compare the Chinese case with relevant law and practice in the West. An example of the former is the comparison made in the respect of the relationship between state enterprises and the government authorities.²¹ Examples of the latter include the ultra vires rule,²² directors' duties,²³ workers' participation,²⁴ and

²⁰ Supra note 7.

²¹ See Chapter Four.

²² See Chapter Three.

²³ See Chapter Six.

²⁴ See Chapter Seven.

bankruptcy rules.²⁵

The research upon which this thesis is based relies primarily on documentary sources. The extensive attention paid by many observers to Chinese state enterprise reform has provided me with access to much material in Chinese and English-language publications. Although most of these materials are not aimed at the legal analysis of this reform, they nevertheless offer valuable insight into both the operation of Chinese state enterprise and the difficulties in reforming state enterprises in the PRC. In addition to relying on the published materials, I myself made two visits to China of two months each. During these visits, fieldwork was carried out in order, inter alia, to assess the accuracy of my documentary sources. In particular, I conducted interviews, in Beijing and Nanjing, with law professors, relevant government officials, factory directors, party secretaries, and trade union officials within enterprises. They provided me with valuable first-hand information about the implementation of the laws relating to state enterprises.

D. Scope and structure

This thesis is unable, for reasons of space, to discuss all the legal aspects of Chinese state enterprise reform. For example, although both the contracting and shareholding systems have been employed to reform state enterprises, this thesis deals only with the contracting or chengbao system.²⁶ This is because the shareholding system, or gufenzhi, which was introduced in the mid-1980s is so far still in the stage of cautious experimentation rather than in large-scale operation. Moreover, as will be analyzed in Chapter Two, relevant documents concerning shareholding enterprises were

²⁵ See Chapter Eight.

²⁶ See Chapter Nine below.

not formally promulgated until June 1992.²⁷ And these documents are only semi-legal in that they were adopted neither by the NPC nor by the State Council. They were only issued by the State Economic Reform Commission and relevant Ministries as temporary and experimental measures. Therefore, they are neither "laws" nor "regulations", but merely documents which purport to have certain legal effect.²⁸ In fact, given the controversy involved and the limited experience, the effects of such experimentation remain to be seen. Accordingly, I can only provide a preliminary view of this experimentation in the relevant chapters, although I try to give greater attention to it in the concluding chapter of the thesis.

It must be noted that the Chinese government has persistently made clear that the shareholding system must be experimented with on the basis of the public ownership including state and collective ownership. However, the involvement of private shareholders poses a serious threat to the property ownership structure of shareholding enterprises. As a result, shareholding enterprises may eventually be governed by a Company Law which differs from the SEL. Thus, this thesis will ignore shareholding enterprises and focus on

²⁷ These documents consist of fifteen items at three different levels. At the first level is a general document: Measures Concerning the Experimentation of Shareholding Enterprises (for the text in Chinese, see RMRB, Jun.19, 1992, p.2; for the English text, see BEC SWB, Jun.19, 1992, FE/1411 C1/1-3); at the second level are two major documents: Normative Opinions Concerning Limited Liability Companies, and Normative Opinions Concerning Companies Limited by Shares. At the third level are a series of documents relating to macro administration, accounting, labour and wages, taxation, auditing, fiscal administration, material supply and sale, state assets administration, industrial and commercial registration, statistics, issuance and trading of shares, and shareholding experimentation of new projects. For a report announcing the promulgation of these document, see RMRB, Jun.19, 1992, p.1.

²⁸ According to the official view, these documents have only "relative legal nature" (xiangdui de falü xingzhi) until a Company Law has been adopted. See the report, RMRB (Overseas edn.), Jun.24, 1992, p.2.

state enterprises which are wholly owned by the state and which do not issue shares to the public.

Indeed, even by focusing on the reform of traditional wholly state owned state enterprises, it is not possible for this thesis to analyze many issues which are directly connected with this complex reform. For example, the issue of competition -- which certainly does affect the performance of state enterprises -- has to be put aside. Moreover, the policy towards enterprise grouping -- a policy which has been emphasized by the Chinese government as a method for reorganising industrial structure and promoting economic efficiency -- is only discussed to a limited extent.²⁹ In addition, the local government control of state enterprises, which can be very significant in some cases, is only discussed generally and without reference to any detailed case study.³⁰

Nevertheless, by selecting and addressing in detail issues which I consider to be the most important and relevant, my analysis and discussion should provide a good view of both the progress made, and the difficulties which still exist, in the legal regulation of state enterprises in China.

Although the structure of this thesis broadly follows the traditional approach used for analyzing Western company or corporation laws, it is also necessary to look at certain issues peculiar to the PRC context. For example, the problem of corporate personality which nowadays does not require much explanation in most treatises on company law in the West must be examined in detail. This is because the legal person concept is given considerable emphasis by both PRC authorities and scholars; much hope has been placed on this concept within China for enhancing the independence of state enterprises. Another example is the issue of worker's participation in enterprise management. In the West, this topic is usually treated in the context of labour law or the law of industrial

²⁹ See the discussion concerning legal personality in Chapter Three of the thesis.

³⁰ See, for example, Chapter Four of the thesis concerning enterprise autonomy.

relations. However, in China, the issue of workers' participation is officially viewed as a subject of great importance, which is treated in detail in the SEL. It has also generated much controversy. Accordingly, it deserves special analysis within the context of this research.

The thesis is divided into ten chapters. The remainder of this chapter continues to introduce the main topic of the present study, namely enterprises. While emphasis is given to the distinctive features of state enterprises in the PRC's socialist economy, other types of enterprises currently operating in China are also discussed in order to provide the reader with a more comprehensive view of the Chinese enterprise system.

Chapter Two reviews theories of the company and enterprise law and the Chinese experience of enterprise law and policy. The discussion covers the period of the development of modern enterprises in China since the 1860s. It looks at, in particular, the late Qing law reform in the 1900s, and concludes with the adoption of the SEL in 1988. The PRC experience in relation to the law and policy of enterprises since 1949 is examined in order to provide a broader understanding of the issues of state enterprises, and of the position of the law in relation to policy.

Chapter Three examines the role of the legal person concept in state enterprise reform and the law. It focuses on the introduction and the application of the notion of legal person to state enterprises in economic reforms. It gives particular attention to the apparent difficulties experienced in defining property rights for state enterprises as legal persons. Other problems such as liability, the ultra vires rule, and the possibility of lifting the corporate veil are also discussed.

The legal analysis of the relations between state enterprises and miscellaneous government departments is conducted in two separate chapters -- Chapters Four and Five. The general legal guarantee of enterprise autonomy, freedom from government manipulation, is analyzed in Chapter Four.

This is the most central issue in the legal regulation of state enterprises. "Relative" (xiangdui de) autonomy of enterprises is widely described by the Chinese government as not only the starting point but also the declared aim of state enterprise reform. This policy is so important that the SEL and relevant regulations have addressed it in detail.

The financial autonomy of state enterprises is examined in Chapter Five. To a significant extent, the autonomy of state enterprises is dependent on their financial autonomy. However, this issue is so fundamental that frequent and significant policy changes -- which may undermine relevant legal norms -- have been made during the reform. It remains an area which will see further changes.

Chapter Six is concerned with the legal status of enterprise directors. The discussion examines the difficulties encountered in establishing the authority of directors in state enterprises. The most difficult issue has been the proper treatment, including a legal definition, of the management power and status of both enterprise directors and party secretaries within state enterprises. In addition, the discussion also points out the inadequacy of Chinese law concerning the legal duties of enterprises directors.

Chapter Seven concerns workers' participation in enterprise management. Worker's participation is an issue of political and ideological importance which also receives legal treatment in the SEL and relevant regulations. But, as will be shown, rights of participation are not only conceptually vague but also remain difficult to enforce in practice.

Chapter Eight discusses the issues of liquidation, bankruptcy, and reorganisation of state enterprises. The introduction of the Enterprise Bankruptcy Law in 1986 was seen as a significant step towards promoting business efficiency of state enterprises. However, due to considerable controversy, as well as defects in the social security system, the law has not really been enforced.

Chapter Nine examines the contracting system as an important legal mechanism employed in state enterprise reform.

To a great extent, the discussion assesses the effects and the limits of the contracting system on the legal authorization of autonomy to state enterprises.

In the final chapter, conclusions are drawn about the results of the existing legal regulation of Chinese state enterprises, and on the general analysis of the interaction of law, policy, and administrative powers in the process of economic reforms. The thesis ends with an examination of recent developments and a discussion about the future prospectus of the laws governing state enterprises.

II. Different Enterprises in the PRC

The term "enterprise" (qiye) as a legal concept, although used widely, has no fixed and strict meaning in the legislation of the PRC. Generally speaking, an enterprise may be defined as an economic unit which is engaged in production and service activities and which conducts independent accounting.³¹ Such a general description is, however, of little significance to the legal analysis of enterprises since, as we shall see, the nature and the characteristics of different enterprises may vary greatly.

As a result of the post-Mao economic reform and policy of opening to the outside world, the Chinese economy is moving towards a "mixed" type of economy.³² In contemporary China, many types of enterprises coexist and to a certain extent

³¹ This is the definition of "enterprise unit" in Faxue Cidian (Law Dictionary), Shanghai Dictionary Press 1985, pp.325-6. Compare with the definition that an enterprise is "a venture or undertaking especially one involving financial commitment" (see Black's Law Dictionary, West Publishing Co., 5th edn. 1979, pp.476-7).

³² The term "mixed economy" is used here to refer to an economy in which state, private and other enterprises coexist. However, "free market" which is seen by some Western observers as a precondition for using the term of "mixed economy" does not yet exist in contemporary China. For a discussion on the definition of "mixed economy", see W. Friedmann (ed.), Public and Private Enterprise in Mixed Economies, Stevens & Sons (London) 1974, pp.360-2.

compete with one another. By the end of 1991 the number of enterprises registered in the PRC reached nearly 5 million.³³ Of these, the number of state enterprises, collective enterprises, and associated enterprises accounted for 4.82 million;³⁴ the number of private enterprises totalled about 108,000;³⁵ and the number of foreign investment enterprises was 37,189.³⁶

A. State enterprises

In the West, state enterprises are widely known as "public corporations",³⁷ "government enterprises", or "public enterprises". Despite the virtual absence of a statutory definition in Western legislation, "public corporations" are seen to be invariably associated with public affairs or public interests.³⁸ All public corporations possess legal

³³ For this information, see Baokan Wenzhai (Digest of Newspapers and Periodicals), Mar.3, 1992, p.2. This figure does not include individual business and individual partnership, both of which are sometimes generally regarded as "enterprises" (qiye).

³⁴ Ibid.

³⁵ Ibid.

³⁶ Ibid. The numbers for equity joint ventures, cooperative joint ventures and wholly foreign-owned enterprises were respectively 22,791, 8497 and 5901.

³⁷ The term "Public corporation" in the West (or "public companies" as used in the UK legislation) is also used to describe corporations whose shares are traded by the public. In this sense, the term "public corporation" is used to distinguish from "private corporations" (or "private companies" in the UK) which impose restrictions on the trading of their shares.

³⁸ For example, a public corporation is defined as "an artificial person ... created for the administration of public affairs." See Black's Law Dictionary, supra note 1, pp.1105-6. Similarly, public corporations are described as "corporate bodies established by statute to own, manage, and operate utilities and industries in the public interest". See David M. Walker, The Oxford Companion to Law, Clarendon Press (Oxford) 1980, p.1013.

personality. However, because of their close connection with the government, they are vulnerable to administrative and political interference.³⁹

In China, the official definition of a "state enterprise" (guoying qiye)⁴⁰ is "enterprise owned by the whole people" (quanmin suoyouzhi qiye). State enterprises represent the most orthodox form of economic organisation and also constitute the most important part of a socialist economy. In the PRC, state enterprises, especially those of large and medium-size, have been the "backbone" in the national economy. For example, by 1991 there were about 11,540 large and medium-sized state

³⁹ See for example the analysis in W. Friedmann and J.F. Garner (ed.), Government Enterprise: A Comparative Study (hereafter "Government Enterprise"), Stevens & Sons (London) 1970.

⁴⁰ Strictly speaking, the term "state enterprise" can be understood as referring to either "enterprise owned by the state" (guoyou qiye) or "enterprise managed by the state" (guoying qiye). Such a distinction may appear to have purely theoretical significance. However, as some scholars noted, in the process of the economic reforms, Chinese state enterprises which used to be directly "managed" by governmental authorities should be transformed to enterprises which are merely owned by the state but managed by the enterprises themselves. See for example Wang Baoshu and Cui Qingzhi, Gongye Qiyefa Dagang (Outline of Enterprise Law), Current Affairs Press (Beijing) 1985, "Postscript", at p.180. For a discussion of this transformation, see Chapter Two of the thesis.

Before 1952, in communist-controlled areas of China, there existed a distinction between "state - owned industries" (guoying gongye) which referred to enterprises owned and managed by a government or military region above provincial level and "public factory" (guoying gongchang) which was owned and managed by a province or county. On Sept. 1952, the Government Administration Council issued the Provisions Concerning the Usages of Names of State Enterprises, which required that from then on "state enterprises" (guoying qiye) should be used to refer to enterprises invested and managed by the Central Government and departments of large administrative regions, including those trusted by an administrative region to a province or city to manage, and that enterprises invested and managed by governments under the provincial level should be called "local state enterprises" (difang guoying qiye). For the text of these Provisions in Chinese, see Laws and Regulations of the Central PRC Government (1952), p.112.

industrial enterprises.⁴¹ This number was only 2.5 per cent of the total number of all Chinese industrial enterprises, but the output of these large and medium-sized state enterprises accounted for about 45.6 per cent of the total output of all Chinese industrial enterprises.⁴² Moreover, the income contributed by these large and medium-sized state enterprises to the state constituted more than sixty per cent of the total provided by all Chinese industrial enterprises.⁴³ On the other hand, the number of workers employed by state enterprises had, even by the end of 1989, already topped one hundred million.⁴⁴ Thus, state enterprises are extremely important in the Chinese economy and it is simply impossible to underestimate their significance. Let us now examine the main features of state enterprises.

In the mid-1970s, a Hungarian academic, inspired by the economic reforms taking place at that time in Eastern Europe, summarised the principal criteria for describing a socialist state enterprise as: "separate enterprise property as basis of the economic activity; the enterprise's status as state organ; the enterprise as a collective body; the principle of compliance with the plan; independent economic accounting; legal personality".⁴⁵ Some of these features, such as state organ and state planning, reflected the then prevailing

⁴¹ For the classification of Chinese state enterprises and its effect on enterprise legislation, see the discussion below.

⁴² Information from the editorial "Jizhong Liliang Gaohuo Guoying Dazhongxing Qiye" (Putting Together Our Strength and Invigorating Large and Medium-Sized State Enterprises), RMRB (Overseas edn.), Oct.7, 1991, p.1.

⁴³ Ibid.

⁴⁴ RMRB, Feb.3, 1990, p.1. This number accounted for almost one tenth of the total Chinese population. The importance of this figure becomes clearer when one notes that as a agricultural country, eighty per cent of the Chinese population are peasants and farmers.

⁴⁵ Laos Ficzere, The Socialist State Enterprise, Akademiai Kiado (Budapest, Hungary) 1974, p.35.

situation of Chinese state enterprises. However, other features, such as separate enterprise property and legal personality, were completely unthinkable at that time for the Chinese leadership. This was mainly because during the 1960s and 1970s Chinese state enterprises operated under comprehensive government administration and therefore did not possess any real independence.⁴⁶

In the course of the economic reforms started in 1979, almost all the features described by that Hungarian academic in the 1970s have been officially acknowledged in China and incorporated into relevant laws, especially the GPCL and the SEL. Basically, the SEL defines a state enterprise as,

a socialist work unit which is engaged in producing and managing commodities and which enjoys autonomy in accordance with the law in respect of its business operations, which is responsible for its profits and losses, and which conducts independent accounting.⁴⁷

On the one hand, this definition illustrates basic features of state enterprises; on the other hand, however, it fails to reveal explicitly some important aspects of the distinctive nature of state enterprises. Many of the features of Chinese state enterprises will be explored in detail in the following chapters. At this stage, the characteristics of the state enterprise may be generally described in terms of three different aspects: economic, social and administrative, and political.

1. Economic organisation

The economic feature seems to be common for all types of enterprises across the world. That is, enterprises must be engaged in economic exchanges by producing goods or providing services. However, prior to economic reforms, this feature was far from being an explicit feature for Chinese state enterprises. For many years, Chinese state enterprises were "appendages" (fushuwu) of governments and their departments,

⁴⁶ For a more detailed description, see Chapters Two and Three of this study.

⁴⁷ Art.2.

rather than independent economic entities. In fact, in the wake of economic reforms, fierce debates arose in China regarding the economic nature of state enterprises. This debate appeared to focus on the degree of autonomy which a state enterprise should possess. But the crucial issue underlying the debate was whether or not the Chinese economy was a commodity economy in which state enterprises, like many other types of enterprises, might become independent economic entities. That debate came to an end in October 1984 when the Central Committee of the Communist Party of China adopted the Decision Concerning Reforms of the Economic System ("Party Decision"). This Party Decision, which has had a profound impact on the process of Chinese urban economic reforms, for the first time in PRC history explicitly recognised that the Chinese economy was a planned commodity economy based on public ownership.⁴⁸ As a result of this development, state enterprises have been required to become independent commodity producers and managers. Therefore, by officially denying the governmental nature of state enterprises, the economic aspect of the state enterprises has been acknowledged and emphasized.

One important point, however, should be noted. That is, although they are encouraged to make profits, state enterprises are not necessarily profit-making institutions. According to the orthodox socialist theory, the fundamental aim of socialist production is not to pursue economic profits, but to satisfy the increasing material and cultural needs of the people. This feature has also been expressly recognised by

⁴⁸ Since mid-1992, a new term has been emerging in China. Many people, led by the General Secretary of the CCP, Jiang Zemin, have preferred to use the notion of "socialist market economy" (shehui zhuyi shichang jingji) to describe the nature of the contemporary Chinese economy. It must, however, be noted that this new term, by defining the economy as a market economy, contradicts the constitutional provision which prescribed the Chinese economy as an essentially "planned economy" with the "supplementary role" of the regulation by the market. (see Art.15, 1982 Constitution).

the SEL.⁴⁹

As a matter of fact, when the draft SEL was published in early 1988 for public ^{consultation}, it was suggested by some academics⁵⁰ that the law should explicitly recognise the profit-making goal of state enterprises as people would not permit the continuous operation of loss-making enterprises. This proposal was, however, not accepted. Many possible reasons may account for this rejection. The most important may have been that the profit-making orientation would, in the orthodox view, conflict with the above noted paramount aim of socialist production. Moreover, state enterprises are not pure economic organisations since they are also administrative and political institutions.⁵¹

2. Social and administrative organisation

In the PRC, social and administrative features of state enterprises were most pronounced before the post-Mao era of economic reforms. For many years until the late 1970s, governments at different levels and their departments directly managed enterprises. And to a great extent through the overall administration of enterprises, the government was able to command effectively the society. As such, enterprises merely operated as state organs and performed various administrative

⁴⁹ Art.3 of the SEL provides that the fundamental tasks of the state enterprise shall be to develop commodity production, create wealth, increase accumulation (of wealth) and meet "the growing needs of the people with respect to their material and cultural lives" in accordance with state plans and market demand.

⁵⁰ See for example professor Xie Huaishi, "Qiyefa Mouxie Tiaowen Zhi Wojian" (My Opinions on Some Provisions of the Draft SEL), GMRB, Feb.4, 1988, p.3.

⁵¹ Immediately after June 1989, the tendency to put emphasis on the economic feature of state enterprises was attacked mainly on the ground of the socialist nature of state enterprises. See Fan Ping, "Shixing Dangzheng Fenggong Yu Jianchi He Jianqiang Dang de Lingdao" (Implementing the Separation of the Party from the Administration and Adhering to and Strengthening the Leadership of the Party), BJRB, Oct.11, 1989, p.3. Also see Chapter Six of the thesis.

functions. Connected with the administrative functioning are the social functions that state enterprises had to (and still do) carry out. For example, state enterprises, in particular large or medium-sized ones, were (and still are) required to provide their workforce with many social and welfare services which in the West are usually provided by government agencies, social and economic institutions, as well as the market. These services range from the building and distribution of housing facilities to the education of workers' children. It is mainly because of these social functions that Chinese state enterprise are often informally referred to in the PRC as "small societies" (xiao shehui).

Urban economic reforms introduced since 1984 have aimed at reducing government intervention with regard to the management of enterprises and, more generally, at granting enterprises a certain degree of independence. As will be shown in Chapter Four, the SEL grants relative autonomy to state enterprises and requires them to concentrate on economic performance. In addition, government authorities are required to take up many social responsibilities previously performed by enterprises. Nevertheless, the social and administrative features of state enterprises can be neither eliminated immediately nor eradicated completely. For example, state economic plans -- comprising guidance as well as compulsory plans -- continue to play a significant role in the PRC's socialist economy.⁵² Moreover, the state enterprise is still held responsible for administering labour on behalf of the state, though it has been given more autonomy to employ and dismiss workers. In addition, enterprises continue to carry out many social responsibilities and are not allowed to pass these responsibilities to the government and the public.⁵³

⁵² For an assessment of the role of the state plan in contemporary China, see Chapter Three below.

⁵³ For example, in the current housing reform, though the state and the individuals stand to contribute more towards housing construction, enterprises themselves are still put under an obligation to make large contributions.

The social and administrative features of enterprises may severely affect the economic functioning of the latter. Enterprises have to carry out state economic plans, and their autonomy in making decisions concerning production, pricing and many other aspects is still limited. It follows that profit-making may not always be set as the ultimate aim of their operations. Indeed, there always exists a contradiction between economic efficiency -- through effective production and services -- and social efficiency -- through the performance of various social responsibilities. This contradiction has added considerable difficulties to state enterprise reform. For example, because of the consideration for social issues such as employment and social stability, many state enterprises continuously making losses are not necessarily threatened by the bankruptcy law.⁵⁴

3. Political organisation

The socialist nature of state enterprises lies particularly in their political role.⁵⁵ In socialist countries, it is generally believed that ^{the} political ^{objective} of enterprises can boost workers' enthusiasm which ultimately enhances production efficiency. Worker's participation in enterprise management is not only a matter of social and political necessity but also an important means for promoting economic ends, and therefore must be guaranteed by law.⁵⁶ Moreover, in order to uphold and reinforce the leadership of the Communist Party, the establishment of grass root party organisations is required within state enterprises. In order to maintain their authority within enterprises, party organisations must be involved in enterprise management. This has proved a difficult area in state enterprise reform and

⁵⁴ See the discussion in Chapter Eight of the thesis.

⁵⁵ For a detailed account of this aspect, see Andrew G. Walder, Communist Neo-Traditionalism (Work and Authority in Chinese Industry), University of California Press 1986, especially Chapter 3, "The Party-State in the Factory".

⁵⁶ See Chapter Six of the thesis.

subsequent legal treatment of state enterprises.⁵⁷

Thus, Chinese socialist state enterprises possess not only economic and social, but also administrative and political characteristics, and these features combine to make the nature of state enterprises very complicated indeed. It must, nonetheless, be noted that these three aspects of Chinese state enterprises may not always hold an equal weight. Before the post-Mao economic reforms, the administrative aspects of state enterprises were most significant and their economic features were largely neglected. However, since the beginning of economic reforms in the late 1970s and early 1980s, the economic aspect of state enterprises has been promoted to occupy a more important position in their overall functioning. Of course, such changes in emphasis are bound to affect the operational aim and structure of state enterprises. For example, the stress placed on the economic function of state enterprises in the era of economic reforms has not only required a reduction in enterprises' administrative functions, but also necessarily touched the nerve of the political aspect of state enterprises. Indeed, as will be shown in the discussion of later chapters, the new policy has caused considerable confusion and chaos within state enterprises.

B. Other enterprises

In order to understand the social, economic and political environment within which state enterprises are operating, it is necessary to examine briefly those enterprises with which state enterprises are competing. Some of the concepts discussed below are either unknown or easily misunderstood in the West. Indeed, some concepts, such as gongsi or "company" and jiti qiye or "collective enterprise", are almost incomprehensible, even for Chinese lawyers.

⁵⁷ See Chapter Six of the thesis.

1. Collective enterprise

"Collective enterprise" (jiti qiye) and its longer name - - "collectively-owned enterprise" (jiti suoyouzhi qiye) -- are widely used terms in China. A collective enterprise may be formed in various ways. Traditionally, a collective enterprise is established on the basis of capital contributions made by members of collectives such as township, street, commune, production team, and many other units. Moreover, these collectives may by themselves invest to set up collective enterprises. In addition, a collective enterprise may be formed as a result of the financial support from the state or other enterprises. For example, since the late 1970s, in order to ease the problem of unemployment, state and collective enterprises have been encouraged by the government to invest in new businesses. A great majority of these newly-created businesses are by nature collective enterprises, and they give priority in employment to those people whose parents work in the units which first invested in, and thereby set up, these collective enterprises.⁵⁸

Collective enterprises may be established in urban as well as rural areas. In fact, one of the most notable achievements in Chinese rural economic reforms has been the dramatic growth of rural enterprises. These rural enterprises are usually called xiangzhen qiye or "township enterprises". Most township enterprises are classified by Chinese authorities as collective enterprises.⁵⁹ In fact, in many

⁵⁸ Although these newly established enterprises are deemed to be independent legal persons, they do have administrative connections with those enterprises which promoted them. To certain extent, the original investment made by an enterprise is treated as a loan repayable by the newly founded enterprise.

⁵⁹ Strictly speaking, Xiangzhen qiye which developed from the so-called "commune-team enterprises" (shedui qiye) is not a legal term. The Circular on Transmitting the "Report on Initiating a New Situation in Commune-Team Enterprises" submitted by the Ministry of Agriculture, Animal Husbandry and Fishery and the Leading Party Group of the Ministry, jointly issued by the Central Committee of the Chinese Communist Party and the State Council on Mar.1, 1984, defined xiangzhen qiye

areas, especially the coastal provinces, township enterprises have become the dominant economic force in the local economy.

A legal analysis on Chinese collective enterprises is by no means an easy task. As one Chinese lawyer put it, "of the existing discussions concerning various enterprises, the discussions on collective enterprises are the most ambiguous and complicated."⁶⁰ Many difficulties exist in examining the nature of collective enterprises. The State Council has promulgated two sets of regulations concerning collective enterprises: Regulations Concerning Collective Enterprises in Rural Areas,⁶¹ and Regulations Concerning Collective Enterprises in Cities and Towns.⁶² In addition, the Ministry of Agriculture has also adopted the Interim Provisions Concerning Peasants' Joint Stock Cooperative Enterprises.⁶³ But the absence of a comprehensive treatment of various types of collective enterprises may cause many problems, including ambiguity and inconsistency in the relevant legislation.

A collective enterprise requires capital contribution from the collective and possibly its members and other units, but the mere fact that the capital contribution of an enterprise is made by two or more entities does not

as "enterprises formed by communes (township) and production teams (villages), cooperative enterprises jointly-operated by some peasants, and other forms of cooperative industries and industrial enterprises." From this definition, xiangzhen qiye embraces not only collective enterprises, but also individual and private enterprises.

⁶⁰ Zhao Xudong, "Jiti Qiye Faren Yanjiu", ZGFX, No.1, 1991, pp.62-9, at 62.

⁶¹ Adopted by the State Council on May 11, 1990 and effective as from July 1, 1990. The regulations, as indicated in Art.2, do not apply to agricultural production cooperatives, rural supply and marketing cooperatives, or rural credit cooperatives.

⁶² Promulgated on Sept.9, 1991, and effective as from Jan.1, 1992. For the text in Chinese, see RMRB, Sept.18, 1991, p.2. For the English translation of the Regulation, see BBC SWB, Oct.16, 1991, FE/1204, C1/1-6.

⁶³ Promulgated on Feb.12, 1990. For the text in Chinese, see Collection of Company Laws and Regulations, pp.1288-94.

necessarily make the enterprise a collective one. This is because individual partnership and some limited liability companies are in fact "private businesses", rather than "collective enterprises".⁶⁴ In addition, "cooperatives" as a type of economic organisation may not even be included in the larger category of "collective economy."⁶⁵

In order to distinguish a collective enterprise from a non-collective enterprise, one has to consider the following features. First, a collective enterprise must be collectively owned by the "working people" (laodong gunzhong). Of course, the actual meaning of such collective ownership may vary from enterprise to enterprise, depending on the identities of the capital contributors of the enterprise in question. According to the Regulations Concerning Collective Enterprises in Cities and Towns,⁶⁶ "the collective ownership of the working people" may have three different meanings. The first is collective ownership by the working people of the enterprise concerned. This is often the case where various individuals who work in the enterprise are direct investors in, and beneficiaries of, a small-sized collective such as a production team. The second

⁶⁴ See the discussion below regarding "private enterprises".

⁶⁵ "Cooperative economy" (hezuo jingji) in China is a very complicated field indeed. Confusion between the meaning of "cooperatives" and that of "collective enterprises" may only be explained from the historical point of view. In the early days of the PRC, various forms of cooperative were very popular. However, in the mid-1950s, with the compulsory and swift move towards the complete collectivization of the individual economy, all cooperatives were ordered to be transformed into collective enterprises. For many years between the late 1950s and late 1970s, cooperatives disappeared. It is only since the beginning of the economic reforms that cooperatives have been encouraged to develop. However, most cooperatives have lost their original characteristics and become collective enterprises. Unlike other cooperatives, they are more like individual and private businesses, including partnerships. For a discussion of this development, see Huang Daoxia, Hezuozhi Yanjiu (Studies on the Cooperative System), Rural Reading Material Press (Beijing) 1987, pp.38-40.

⁶⁶ Art.4.

meaning of the collective ownership is collective ownership by the working people of the joint economic organisation to which the collective enterprise belongs. This is usually the case where a collective unit such as a township is large in scale, and only a small number of its members are working in the enterprise concerned. The third possibility is that, for a collective enterprise with two or more principal investors, the collectively owned assets of the working people in one of above two situations must occupy a dominant position. Here the dominant position means that under ordinary circumstances, the collectively-owned assets of the working people should constitute not lower than fifty-one per cent of the enterprise's total assets.⁶⁷ However, it must be noted that, despite the provision that the property of collective enterprises is owned by the working people of the collective, (an issue further explored in Chapter Three), the law seems to suggest that those collective enterprises which are legal persons may also own the property which they manage.

Secondly, a collective enterprise must be under collective and "democratic management". Profits made by the collective enterprises must be mainly distributed according to labour rather than capital contributions.⁶⁸ These features are seen as being able not only to guarantee the ownership status

⁶⁷ Ibid. However, this article also provides that such a proportion may be lowered appropriately under special circumstances and after approval by the original examining departments.

⁶⁸ See Arts.4, 5, & 9 of the Regulations Concerning Collective Enterprises in Cities and Towns; also see Arts.18 & 26 of the Regulations Concerning Collective Enterprises in Rural Areas. As far as profit distribution is concerned, according to the Regulations Concerning Collective Enterprises in Cities and Towns, the profits after taxation must be distributed autonomously by the enterprise in accordance with the ratios set by the state concerning accumulation funds, public welfare funds, labour remuneration, and payment for investment and shares (Art.46). The payment for investment and shares must be combined with the profitability of the enterprise. If the enterprise is suffering losses, then no such payment may be made until the losses have been made up (Art.48).



of the workers in the enterprises, but also to prevent enterprises from "exploiting" their workers.

Thirdly, the legal personality of collective enterprises is uncertain. While collective enterprises in cities and towns may, after registration, automatically acquire legal person status,⁶⁹ it seems that not all collective enterprises in rural areas may obtain legal personality. In fact, rural collective enterprises may become legal persons only after examination and registration by relevant authorities.⁷⁰ Some rural collective enterprises may not be eligible for legal person status because they do not possess the necessary qualifications.⁷¹ However, it is not clear what types of collective enterprises are disqualified in this way from becoming legal persons. Furthermore, the issue of civil liability for collective enterprises that are not legal persons is uncertain, though it is likely that such liability may be resolved by reference to general principles regarding individual partnership⁷² or special contracts concluded in advance.

Fourthly, unlike individual partnerships, the property of collective enterprises cannot be divided and taken away either by the workers of the enterprise or by the members of the collectives which formerly promoted the enterprises. Instead,

⁶⁹ Art.6 of the Regulations Concerning Collective Enterprises in Cities and Towns.

⁷⁰ See Art.10 of the Regulations Concerning Collective Enterprises in Rural Areas.

⁷¹ In this case, these collective enterprises can only obtain from the appropriate Administrative Bureau of Industry and Commerce a "Business License", rather than a "Legal Person Business License". For the differences between ordinary Business License and Legal Person Business License, see Arts.38 & 39 of the Implementing Rules of the Regulations Concerning the Administration of Legal Person Registration, adopted by the State Administrative Bureau for Industry and Commerce on Nov.3, 1988. Also see the different treatment for Business License and legal Person Business License in Art.14 of the Regulations Concerning Collective Enterprises in Rural Areas.

⁷² See Arts.30-35, GPCL.

in order to protect collective property, special regimes govern the property arrangement in case of liquidation of the collective enterprises. In principle, the remaining assets, if any, of a collective enterprise after its liquidation shall be kept in the hand of the collective which promoted the enterprise in the first place.⁷³

As such, to a certain extent, collective enterprises resemble state enterprises. In the PRC, both state enterprises and collective enterprises are officially regarded as public ownership enterprises in nature. It would be misleading to refer to Chinese collective enterprises either as the "private sector of the economy" or as "private enterprises".⁷⁴ In fact, it is because of this public ownership character that both collective and state enterprises may be given the same or similar treatment for certain areas. For example, workers' participation in enterprise management is supported by law for both state and collective enterprises. Also, in implementing the director responsibility system, the status of the Party organisation within collective enterprises is not free from confusion, though this confusion may not be as significant as

⁷³ For example, according to Art.19 of the Regulations Concerning Collective Enterprise in Cities and Towns, the remaining assets of a collective enterprise after its liquidation shall be handled in accordance with the following principles: (1) for a collective enterprise with investments from, and shares held by, the state, units other than the enterprise concerned, individuals and workers of the enterprise, the remaining assets shall be distributed to these investors and shareholders according to the ratio of their investments and shares to the total assets of the enterprise; (2) the remaining assets will be allocated exclusively by the enterprise's superior management organs for the workers' unemployment, old age pension and resettlement and retraining funds. They may not be used for other purposes.

⁷⁴ One example for such misuse is an article entitled "Private Enterprise in China: the Developing Law of Collective Enterprises" (by Howard Chao and Yang Xiaoping), in International Lawyer, Vol.19, 1985, pp.1215-37. It is, however, correct in the West to describe all the enterprises which are not owned by the government as "private" sector of the economy.

that encountered in state enterprises.⁷⁵ In addition, because of their public nature, collective enterprises are from time to time put under favourable legal regimes. Thus, compared to private enterprises, collective enterprises enjoy preferential treatment in taxation.⁷⁶

Despite the similarities between collective and state enterprises, collective enterprises still differ from the state enterprises in many respects. The most important difference is that collective enterprises are not owned by the state. It follows that the legal regulation of collective enterprises differs from that of state enterprises. Generally speaking, collective enterprises enjoy a more flexible legal regime than are state enterprises. For example, collective enterprises are not subject to state plans. The management autonomy of collective enterprises is also protected by the law and is theoretically free from government intervention. We will briefly discuss, where relevant, the similarities as well the differences between the legal treatment of state enterprise and collective enterprises.

2. Private enterprise⁷⁷

"Private enterprise" (siying qiye) in the Chinese context is a specific concept with a definite meaning. According to

⁷⁵ See the discussion in Chapter Five of the thesis.

⁷⁶ While the income taxes for collective enterprises are levied in accordance with eight grade progressive rates ranging from ten per cent to fifty-five per cent, the income tax rate set for all private enterprises is fixed at thirty-five per cent.

During the mid-1980s, many private enterprises sought to connect themselves with collective enterprises in order to enjoy preferential treatment. This led to the decision made by the Chinese government in late 1988 to reclassify enterprises, disqualifying many previously claimed collective enterprises and ordering them to re-register as private enterprises or even individual businesses.

⁷⁷ For a general discussion on the legal approach to private enterprises, see Alison W. Conner, "To Get Rich Is Precarious: Regulation of Private Enterprise in the People's Republic of China", Journal of Chinese Law, Vol.5, No.1, Spring 1991, pp.1-46.

the Provisional Regulations Concerning Private Enterprises adopted on June 3, 1988, a private enterprise is an "economic organisation whose property is owned by individuals, which has eight or more employees, and whose purpose is to make profits."⁷⁸ This definition of "private enterprise" differs from the earlier use of this concept. The most notable difference lies in the requirement concerning the number of employees for private enterprises; the Provisional Regulations Concerning Private Enterprises adopted in 1950⁷⁹ only generally provided that "private enterprises are various economic enterprises which are invested in and run by individuals to make profits", and no specific requirement for the number of employees was present. At present, however, if a private undertaking does not have the minimum number of eight employees, it may not be termed "private enterprise". Rather, it is usually called an "individual enterprise" (geti giye) which is subject to different laws and regulations.⁸⁰

⁷⁸ Art.2.

⁷⁹ See Art.2 of the Provisional Regulations Concerning Private Enterprises issued by the Government Administration Council in December 1950. For the text in Chinese, see Laws and Regulations of the PRC Central Government (1949-50), pp.705-11.

⁸⁰ As far as income taxation is concerned, while private enterprises are made subject to the Provisional Regulations Concerning Private Enterprises adopted by the State Council on Jun.25, 1988, individual businesses have to pay income taxes in accordance with the Provisional Regulations Concerning Income Tax of Individual Industrial and Commercial Households in Urban and Rural Areas, promulgated by the State Council on Jan.7, 1986. The latter regulations set ten grade progressive rates ranging from seven per cent to sixty per cent.

At first sight, "eight" or more employees would appear to be a "magic number". But in the Chinese official view, this requirement has practical as well as ideological justifications. In Marxist theory, a private enterprise which employs eight or more people would enable its investors, by exploitation, to live on the work of these employees. Indeed, before 1988, the Chinese government merely allowed individual businesses to employ up to seven, but not more, workers (including possibly two assistants and five apprentices). For the discussion on the debate concerning the definition on private enterprises, see Conner, supra note 79, pp.9-10.

For a description of individual businesses, see Henry

From the legal definition, it can be seen that the private enterprise has many characteristics that differentiate it from public ownership enterprises, especially state enterprises. First, the property of a private enterprise is owned by individuals. Secondly, it is expressly acknowledged that the purpose of a private enterprise is to make profits. This represents a striking difference from state enterprises to which, as noted earlier, the SEL has refused to attach the element of profit-making. Thirdly, workers in private enterprises are merely "employees"⁸¹ of the proprietors of private enterprises.

In the PRC, private enterprises have suffered many bitter experiences. In the early 1950s, private enterprises were initially encouraged; their rights and interests were protected by the Provisional Regulations Concerning Private Enterprises (adopted in 1950).⁸² However, towards the mid-1950s, private enterprises were first restricted and then compulsorily transformed into collective enterprises or dissolved. Throughout the 1960s and 1970s, private enterprises were virtually non-existent. In the early 1980s, with the beginning of economic reforms, individual businesses were legalized by the Constitution of 1982.⁸³ But the Constitution did not expressly authorize private businesses which operated on a relatively large scale. Indeed, until 1988, apart from several attempts to legalize private enterprises through local legislation, the legality of private enterprises with relatively large scale operations remained uncertain. On April 12, 1988, the First Session of the Seventh National People's

Zheng, China's Civil and Commercial Law, Butterworths 1988, pp.332-34.

⁸¹ The term "employee" (guyuan) is not officially used for public ownership enterprises. Instead, people working for public ownership enterprises are usually termed "workers and staff" (zhigong). See Chapter Seven of the thesis.

⁸² For a discussion of the Regulations, see Chapter Two of the thesis.

⁸³ See Art.11.

Congress amended the 1982 Constitution by declaring that "the state permits the private sector of the economy to exist and develop within the limitations prescribed by law." It was after this amendment that the State Council adopted the Provisional Regulations Concerning Private Enterprises "Private Enterprise Regulations".

According to the Private Enterprise Regulations, a private enterprise may take one of three forms: sole trader, partnership, or limited liability company.⁸⁴ However, only the third form, that is, the limited liability company, may acquire legal personality and assume independent liability. Thus, in private enterprises which take the form of either sole traders or partnership, the owners or partners have to bear personal liability for the debts of the enterprises.

3. Foreign-related enterprise

"Foreign-related enterprises" (shewai qiye), or "foreign investment enterprises" (waishang touzi qiye) have been permitted in China since the policy of opening to the outside world was initiated in 1979. Generally speaking, there are three types of foreign investment enterprises operating in China: "equity joint ventures" (hezi jingying qiye), "cooperative joint ventures" (hezuo jingying qiye), and "wholly foreign owned enterprises" (waizi qiye).⁸⁵

A relatively systematic legal framework has been established in China to govern foreign investment enterprises. With the exception of issues relating to registration, foreign investment enterprises are considered under laws and regulations separate from those governing Chinese enterprises. Moreover, different foreign investment enterprises, though sharing many common problems, are governed by different laws

⁸⁴ See Art.6.

⁸⁵ For a study on the similarities and differences between these three kinds of enterprises, see Zhou Ziya, "A Comparative Studies of Three Kinds of Enterprise Involving Foreign Investment in China", in Legal Aspects of Foreign Investment in the People's Republic of China, China Trade Translation Company Limited (Beijing) 1988, pp.110-25.

and regulations. The only exception is taxation which has only been unified since 1991,⁸⁶ Until 1992, major laws adopted to govern foreign investment enterprises are the Law on Sino-Foreign Equity Joint Ventures,⁸⁷ the Law on Wholly Foreign-Owned Enterprises,⁸⁸ and the Law on Sino-Foreign Cooperative Joint Ventures.⁸⁹ In addition, detailed implementing rules concerning equity joint ventures and wholly foreign-owned enterprises have also been promulgated.⁹⁰

Of these three types of foreign investment enterprises, only equity joint ventures, being limited liability companies, are automatically eligible to obtain legal personality under Chinese law. Whether or not the other two types of enterprises can obtain legal personality depends on whether or not they can meet the requirements for a legal person as set by the GPCL.⁹¹ If they qualify as Chinese legal persons, they may claim ownership rights in their property. If not, investors have to bear personal liability for the debts of the enterprises. Such liability may be ascertained by contract, or it may be joint and several liability.

For equity and cooperative joint ventures, the

⁸⁶ See the Tax Law on Foreign Investment Enterprises and Foreign Enterprises, adopted by the National People's Congress on Apr.9, 1991 and effective from Jul.1, 1991. For the text in English, see China Law and Practice, Vol.5, No.3, 1991, pp.25-35. Also see Implementing Rules Concerning Tax Law on Foreign Investment Enterprises and Foreign Enterprises, promulgated by the State Council on Jun.30, 1991. For the text in English, see ibid., No.7, 1991, pp.16-50.

⁸⁷ Adopted on July 1, 1979 and effective as from July 8, 1979.

⁸⁸ Adopted on and effective as of Apr.13, 1988.

⁸⁹ Adopted on and effective as of Apr.12, 1986.

⁹⁰ The Implementing Rules for the Law on Sino-Foreign Joint Ventures were promulgated by the State Council on Sept.20, 1983. The Implementing Rules for the Law on Wholly Foreign Owned Enterprises were approved by the State Council on Oct.28, 1990 and promulgated by the Ministry of Foreign Economic Relations and Trade on Dec.12, 1990.

⁹¹ See Art.37. Also see Chapter Two of the thesis.

involvement of Chinese capital, especially in the case of the state capital, does not necessarily mean that these enterprises have to face similar problems to those encountered by Chinese public ownership enterprises. In fact, generally speaking, joint ventures have been put into a relatively flexible legal framework. Most importantly, the management autonomy of joint ventures is not in doubt -- at least, it is not as disputable as it is for state enterprises, as will be shown in our later discussions.

4. Company

In the Chinese context, the term "company" (gongsi) and its relationship to "enterprise" (qiye), deserve careful explanation and clarification. It would be wrong to equate unconditionally the concept of "company" as used in contemporary China with the term "company" as employed in the West.

In Western jurisdictions, in spite of the difficulties in giving a precise definition for the term of "company",⁹² the concept is often used to refer to companies limited by shares as well as unlimited companies. In many civil law countries, companies may also take the form of limited liability companies, and limited companies with unlimited liability shareholders.

In China, despite the fact that some local legislation does purport to govern "companies",⁹³ there is no comprehensive and national company law.⁹⁴ The absence of a

⁹² See Gower's Principles of Modern Company Law, Stevens (London), 4th edn. 1979, Chapter 1; Farrar's Company Law, Butterworths (London), 2nd edn. 1988, Chapter 1.

⁹³ For example, the Regulations on Foreign-Related Companies in the Special Economic Zones in Guangdong Province was adopted on Sept.28, and effective from Jan.1, 1987. For a specific discussion, see Clement Shum, "Companies With Foreign Equity Participation in China", Journal of Business Law (London), March 1991, pp.185-95.

⁹⁴ There have been only a number of semi-legal documents promulgated in June 1992. See supra note 27.

company law, however, does not mean that the company does not exist in China. In fact, "company" (gongsi) which is often seen as associated with profit-making, has become a particularly popular term since the early 1980s. In fact, the excessive and uncontrollable development in recent years of various companies has prompted the Chinese authorities to launch two nationwide campaigns to "crackdown" (zhengdun) on companies.⁹⁵

In the Chinese context, the relationship between giye (enterprise) and gongsi (company) may be analyzed as follows.

First, giye is usually understood to include gongsi. In other words, ordinary companies are merely a type of enterprise ^{so broadly} defined as to embrace various business organisations, including even individual and partnership enterprises as mentioned above.

Secondly, the two terms should be distinguished from each other. Essentially, for one reason or another, not all giye are gongsi. The term gongsi may have special meaning both in law and in economics. As far as the economic aspect is concerned, while profit-making may be usually seen as an important goal of companies, this, as discussed earlier, may not always be applicable to state enterprises. Moreover, as regards the legal treatment, companies may be governed by special regimes which differ from those governing other normal enterprises not entitled gongsi. This is illustrated by the different laws and regulations regarding the administration of the approval procedure and registration of "companies" and non-companies.⁹⁶

In many cases, the term gongsi is used in contemporary

⁹⁵ The first was conducted in 1985. This was marked by the promulgation of the Interim Provisions on the Administration of Registration of Companies. The second started in late 1988 and officially concluded in late 1991.

⁹⁶ For a discussion, see Chapter Two of the thesis.

PRC to refer to either companies limited by shares⁹⁷ or limited liability companies,⁹⁸ or indeed both. A general term especially accommodating these two types of company is "stock enterprises" or "shareholding enterprises" (gufenzhi qiye). This form of company is comparable to Western companies and may attract investors of private and public property ownership, including foreign investors.⁹⁹

Thirdly, as exceptions, some gongsi are not ordinary qiye. Such companies are not genuine business organisations. Instead, they are purely administrative organs, or organisations which perform more administrative than business functions. Usually, these organisations are termed "administrative companies" (xingzheng gongsi).¹⁰⁰

⁹⁷ A companies limited by shares is defined as "an enterprise legal person whose registered capital is composed of equal-value shares, whose capital is raised through issuing shares (or warrants), whose shareholders bear limited liability towards its debts, and which shall bear liability with all of its assets". See Art.1 of the Normative Opinions Concerning Companies Limited by Shares, adopted by the State Economic Reform Commission on May 15, 1992 and promulgated in June 1992. For the text in Chinese, see FZRB, Jun.19, 1992, pp.2-3. For the English text, see BBC SWB, Jul.6, 1992, FE/1425 C1/1-13.

⁹⁸ A limited liability company is defined as "an enterprise legal person whose capital is contributed by two or more shareholders, whose shareholders bear limited liability towards the company to the extent of their respective contribution, and which shall be liable with all of its assets." See Art.1, Normative Opinions Concerning Limited Liability Companies, adopted by the State Economic Reform Commission on May 15, 1992 and promulgated in June 1992. For the text in Chinese, see FZRB, Jun.22, 1992, p.2. For the text in English, see BBC SWB, Jun.27, 1992, FE/1418 C1/1-7.

⁹⁹ Foreign investors can either set up shareholding enterprises in special economic zones in China, or have equity participation in Chinese shareholding enterprises through purchasing "B" shares which are specially issued to foreigners.

¹⁰⁰ The existence of administrative companies has far reaching implications in China. For example, in Shanghai, most administrative companies were established in the 1950s in the campaign to supervise and take over private and state-capitalist companies. Because these companies confused business operation and government administration, the reform

For the purpose of this thesis, the relationship between giye and gongsi is treated as follows. First, administrative companies as government departments are not considered as falling within the domain of the present discussion. Secondly, as indicated earlier, companies which take the form of companies limited by shares and limited liability companies are not specifically discussed. They are only discussed for the purpose of comparison with ordinary state enterprises. And thirdly, although companies may be placed under special regimes for certain purposes, many state enterprises entitled gongsi are included in this discussion; these companies do not differ in nature from ordinary state enterprises which are usually entitled "factory" (chang). For example, "the Shoudu Iron and Steel Company" (Shoudu Gangtie Gongsi, "SISC"),¹⁰¹ though entitled as a gongsi, is in fact a typical large-sized state enterprise and is therefore subject to the jurisdiction of the SEL and many other relevant laws and regulations applicable to ordinary state enterprises.¹⁰²

of administrative companies was launched by the end of 1985. Until 1987, of the total seventy-seven municipal administrative companies, fifty-nine had been abolished or absolved, eight had been transformed into business enterprises, and the remaining ten were also reformed in one way or another. See Editing Committee, Shanghai Jingji Gaige Shinian (Ten Years of Shanghai's Economic Reforms), Shanghai People's Press 1989, p.35.

¹⁰¹ Located in the suburbs of Beijing, the SISC is one of the China's largest enterprises producing iron and steel. For a case study of workers' participation in this company, see Chapter Seven below.

¹⁰² For a discussion of the problems concerning the jurisdiction of enterprise law and company law, see Chapter Two of the thesis. Also see Chapter Ten for a general discussion of future of enterprise and company law in China.

CHAPTER TWO

ENTERPRISES, LAWS AND POLICIES IN CHINA

I. Enterprises, Laws and Policies in China Before 1949

A. Modern enterprises and late Qing law reform

It is well-known that imperial Chinese law was mostly a criminal law. In order to maintain imperial power, criminal and administrative laws were emphasized, whereas civil law especially commercial law was neglected. Indeed, for hundreds of years, the Chinese rulers followed the idea of "encouraging agriculture and restricting commerce" (zhongnong qingshang) which made difficult industrial and commercial activity. Only individual ^{and partnership} businesses could survive, and then on a limited scale.¹ This situation remained unchanged until the later period of the Qing Dynasty (1644-1911) when, under both foreign and domestic pressure, the Chinese rulers found it necessary to adopt a more flexible attitude towards industry and commerce.

In the early 1840s, the Qing government was defeated by the British in the Opium War, and in subsequent years, the government had to enter into agreements with Western nations, allowing the citizens of the latter to establish businesses in China, especially in the treaty ports. Being angry about the invasion of foreign powers, some Chinese launched the so-called "Foreign Matters Movement" (yangwu yundong) from the 1860s for the purposes of "self-saving" (ziji) and "self-

¹ It is widely recognised that even in late Ming Dynasty and early Qing Dynasty, in some areas of China, there were signs of the seeds of capitalism. But those seeds could not develop to a significant degree due to the unfavourable social and economic environment.

strengthening" (zhiqiang). From the 1870s onwards, many modern enterprises which relied on Western technology were established. At first, most enterprises were operated by the government (guanban). At a later stage, more companies were operated by merchants (shangban). But throughout the whole process, many enterprises took the forms of either "merchants operating under official supervision" (quandu shangban) or "joint operations by the government and merchants" (guanshang heban).² At that time, the government's attitude towards commerce changed from the conservative view of "encouraging agriculture and restricting commerce" to a more accommodating policy of "promoting industry and commerce as well as agriculture" (nongqongshang bingju). At first, enterprises operated by the government were primarily associated with military and manufacturing industries such as weapon-making and ship-building. Later, government-operated enterprises were expanded to civilian industries to include cotton spinning, paper-making, mining and railways.³

The Foreign Matters Movement and the favourable government policy led to a boom in modern enterprises in China.⁴ However, the early development of modern enterprises

² See, for example, Han-Sheng Chuan, Hanyeping Gongsi Shilue (A Brief History of the Hanyeping Iron and Coal Mining and Smelting Company (1890-1926)), The Chinese University of Hong Kong, 1972. This book provides a very good case study of the first iron factory in East Asia. The factory experienced guanban, quandu shangban and shangban forms in three different stages before it finally failed.

³ For a detailed description of government enterprises in late Qing, see Ye Wanan and Qiu Xianming, Zhongguo Zhi Gongying Shengchang Shiye (Public Industrial Business in China), Central Relics Supply Press (Taipei) 1985. Also for a discussion of the development of modern Chinese enterprises, see Chen Zhen and Yao Luo, Zhongguo Jindai Gongyeshi Ziliao (Materials Relating to History of Modern Chinese Industry), Life, Reading & New Knowledge (Three Associations Press, Beijing) 1957, pp.1-57.

⁴ It is estimated that by the beginning of the Twentieth Century, there were more than 570 companies and that their total investment amounted more than 690 million dollars. Information from Xu Lizhi, "Qingmo de Shangshi Lifa Jiqi Tedian" (Commercial Legislation and its Features in the Late

was not accompanied by the introduction of immediate legislation and sound legal protection. Although the operation of many companies was governed by their own constitutions and by-laws, comprehensive company and commercial legislation did not take place until the early 1900s when foreign laws were studied and law reform was undertaken under official sponsorship.⁵ In fact, it was not until April 22, 1903 that an imperial edict ordered the drafting of a commercial code. The drafting took only a few months and the Commercial Code was given imperial approval on January 21, 1904.⁶ This Code, which was based on Japanese Commercial Code of 1899, was the first modern Commercial legislation in Chinese history. It was composed of two parts: "General Regulations for Merchants" (shangren tonglü), and "Company Law" (gongsi lü). The Company Law, which was the main part of the Commercial Code, defined a company as "an organization whose capital is raised and business is jointly managed".⁷ Four types of companies were allowed to operate: (1) the joint stock company (hezi gongsi);⁸ (2) the joint stock company with limited liability (hezi youxian gongsi);⁹ (3) the share company (gufen

Qing Dynasty), FXYJ, No.3, 1989, pp.89-94 at p.89.

⁵ For a comprehensive discussion of the late Qing law reform, see Joseph K H Cheng, Chinese Law in Transition: The Late Ch'ing Law Reform, 1901-1911, University Microfilms International 1981.

⁶ For an English translation of this Code, see E.T. Williams, Recent Chinese Legislation Relating to Commercial, Railway and Mining Enterprises, Shanghai Mercury Limited, 1904, at pp.7-45.

⁷ Art.1, Company Law.

⁸ Art.4, ibid. "A company whose capital is raised from, and whose name is given by, two or more people".

⁹ Art.6, ibid. "A company whose capital is raised from two or more people and which declares to limit its liability to the amount of its capital".

gongsi);¹⁰ and (4) the company limited by shares (gufen youxian gongsi).¹¹

During the first decade of the Twentieth Century, there were many other important legislation regarding company matters. For example, in June 1904, Tentative Regulations Concerning Company Registration were approved. And on April 25, 1906, a Bankruptcy Law came into existence. In addition, in the 1900s, the Qing government also promulgated many regulations to encourage the development of enterprises by rewarding businessmen and companies.¹²

It is very difficult to give an accurate account of the practical implementation of these company laws and regulations in relation to the development of modern enterprises in the Qing Dynasty. Compared with the Bankruptcy Law which was short-lived and not enforced in practice,¹³ the 1904 Company Law survived a decade before being abolished in 1914. The Company Law declared that it offered protection to companies, as it provided that

all companies already established, together with such as may be hereafter established, as well as all associations, factories, honggs, firms, shops and stores, may apply for registration at the Ministry of Commerce, so that they may all alike enjoy the benefits of

¹⁰ Art.10, ibid. "A company which is formed, whose capital is raised from and whose business is managed by, seven or more people."

¹¹ Art.13, ibid. "A company which is formed, whose capital is raised from, and whose business is managed by, seven or more people, and which declares the amount of its capital and limits its liability to that amount."

¹² Two such examples are Regulations for Commercial Decoration Rewards (1906), Regulations for Rewarding Chinese Business Companies (1906).

¹³ The Bankruptcy Law was repealed on Dec.2, 1907. For an analysis of the law and its failure of being enforced, see Thomas Mitrano, The Chinese Bankruptcy Law of 1906-1907: A Legislative Case History, reprinted from Monumenta Serica 1972-1973, Vol.XXX, Harvard Law School, Studies in East Asian Law: China, No.25.

protection.¹⁴

Furthermore, the Company Law claimed to place various companies, including those operated by officials or merchants or jointly by officials and merchants, under its regulation.¹⁵ However, the "benefits of protection" offered by the law were in reality far from effective. Most notably, although the Company Law authorised the management of a company to its board of directors,¹⁶ in practice, the involvement of officials and gentry made it impossible for companies to pursue independent and efficient business management.¹⁷ This was not only the case for companies operated by the government or jointly operated by merchants and the government, but was also true for those companies operated by merchants.¹⁸ Although the main intentions in allowing the development of merchant companies were to attract private investment and to promote management efficiency,¹⁹ the "official supervision" by government administration or yamen meant that significant

¹⁴ Art.23.

¹⁵ Art.30.

¹⁶ See Art.30, Arts.85-97.

¹⁷ For a brief description of the characteristics of "Confucian official as economic administrator", see Frank King, A Concise Economic History of Modern China (1840-1961), Praeger (New York) & Pall Mall (London) 1969, pp.28-30.

¹⁸ For a comprehensive examination of quandu shangban enterprises, including a detailed case study of the China Merchant's Company, see Albert Feuerwerker, China's early Industrialisation: Sheng Hsuan-Huai (1844-1916) and Mandarin Enterprises, Harvard University Press (Cambridge, Massachusetts) 1968, especially pp.150-88. It was found that mere provisions of the Company Law and the regulations of the company were not able to prevent problems associated with "official supervision".

¹⁹ The latter intention was particularly obvious for those companies which were operated by the government but had to be transformed to merchant operation in order to enhance efficiency. There were also other reasons for the adoption of the quandu shangban form. For example, by adopting this form, some enterprises were given monopolistic powers or tax privileges.

inefficiency was inevitable. In addition, official exaction from companies was common, enriching officials at the cost of the companies.²⁰

Of course, pervasive official intervention was just one of many reasons accounting for the poor management of modern enterprises in late Qing. Among other important factors were the shortage of capital and the backwardness of technology. As a result, despite the government's declared policy of encouragement and some people's anxious desire to develop modern enterprises, the promotion of modern enterprises in the late Qing was largely a failure. However, the commercial legislation of the late Qing is very important in terms of Chinese legal history. For the first time, importation of western laws, especially commercial laws, into China was carried out on a large scale. The codification of commercial laws, including company law, did not fully realise its potential, but it did have some impact on subsequent commercial legislation in China.

B. Republican period

The Qing Dynasty was overthrown by the so-called Xinhai Revolution of October 10, 1911. Then came a government entitled the Republic of China. In 1914, the Republican government abolished the Qing Commercial Code of 1904, and replaced it with two separate Acts: the General Rules for Merchants (shangren tongli) and the Company Regulations (gongsi tiaoli), both of which were based on the unadopted version of the draft Qing Commercial Code of 1911.²¹

²⁰ See Feuerwerker, supra note 18, especially the summary at p.30.

²¹ The Company Regulations allowed four types of companies, namely, (1) the unlimited company (wuxian gongsi); (2) the limited liability company with members of unlimited liability (lianghe gongsi); (3) the company limited by shares (gufen youxian gongsi); and (4) the company limited by shares with shareholders of unlimited liability (gufen lianghe gongsi). These Company Regulations were subsequently revised in 1914 and 1923.

In the late 1920s, a new Company Law was drafted. It was promulgated on December 26, 1929. Subsequently, the Implementing Rules for the Company Law were promulgated on February 21, 1931. Both of them came into effect on July 1, 1931.

At the early period of the Republic of China, one of the basic principles underlying its economic policy was the "Principle of People's Livelihood" (minsheng zhuyi).²² Under the guidance of this principle, the state policy towards businesses followed the tenet of "controlling (private) capital" (jiezhi ziben). This tenet had many legal implications. In addition to the favourable protection offered to minority shareholders (as indeed reflected in the 1929 Company Law), "public enterprises" (gongying shiye) were put at a very important position in the national economy.²³

Under the Republican rule, the main economic sectors in which the operation of public enterprises was allowed or encouraged were: first, areas for the prevention of the domination by private capital; secondly, industries which had the nature of monopoly; thirdly, areas where private investment was unable to develop; and finally, social services which did not aim at making profits.²⁴ However, despite these

²² The Republican Constitution, adopted on Dec.25, 1946, provided that "national economy shall be based on the Principle of People's Livelihood and shall seek to effect equalisation of land ownership and restriction of private capital in order to attain a well-balanced sufficiency in national wealth and people's livelihood." (Art.142)

²³ For an account of the coexistence of public and private economy and its relations to the development in Taiwan, see Wu Nengyuan, "Taiwan Jingji Fazhan de Ruogan Wenti -- Lun Taiwan Gongminying Shuanggui Bingcun de Jingji Tizhi" (Several Problems Concerning the Economic Development in Taiwan -- On the Economic System of the Dual Existence of Public and Private Economy in Taiwan), Dongfang Wenhua (Journal of Oriental Studies), Vol.XXVII, Nos.1 & 2, 1989, pp.38-50.

²⁴ The Republican Constitution provided that "public utilities and other enterprises of a monopolistic nature shall, in principle, be under public operation. In cases permitted by law, they may be operated by private citizens." (Art.144) It continued to stipulate that "with respect to

assumed limits, public enterprises were so widespread that they actually dominated the national economy. In fact, state capital occupied a monopolistic position, whereas the scale of private businesses was limited by law and government policies. Public enterprises inherited many of the characteristics of enterprises operated by the government and enterprises operated by merchants under official supervision in late Qing. The special connection which existed between businesses and government officials and the lack of effective competition meant that low economic efficiency was common.

According to the Law on the Administration of State Enterprises, adopted on January 20, 1949, state enterprises²⁵ may take one of the three forms: first, enterprises solely owned and operated by the government; secondly, enterprises jointly operated by the government and private investors in accordance with special laws concerning the administration of enterprises; and thirdly, enterprises which were jointly operated by the government and private investors in accordance with the Company Law but in which the government owned more than fifty per cent of the capital.²⁶ In particular, in order to accommodate public enterprises, the amended Company Law which was promulgated on April 12, 1946 created a new type of company -- "limited liability company" (youxian zeren gongsi).

The dominance of public enterprises continued after 1949

private wealth and privately-operated enterprises, the state shall restrict them by law if they are deemed detrimental to a balanced development of national wealth and people's livelihood." (Art.145) Also see Ye and Qiu, Zhongguo Zhi Gongying Shengchang Shiye (Public Industrial Businesses in China), Central Relics Press (Taipei) 1985, p.212.

²⁵ In Republican terminology, "state enterprise" (guoying shiye) is a concept which is narrower than "public enterprise" (gongying shiye). While the former refers to enterprises exclusively or mainly by the central government, the latter is broader in that it includes enterprises exclusively or mainly owned by central as well as local government.

²⁶ See Art.3.

on Taiwan.²⁷ Only since the late 1950s and early 1960s has the private economy been allowed to play a substantial role. This new policy was in fact not only a necessary step to promote the economic efficiency of public enterprises but also a direct result of foreign pressure.²⁸ At the same time, a number of public enterprises have been privatised.²⁹ Consequently, the overriding role of public enterprises in Taiwan has gradually declined.³⁰ Nevertheless, and although often criticised for their inefficient management, official involvement and excessive government intervention,³¹ public enterprises which mainly rely on their statutory monopoly and privileges still occupy an important position in many industries including banking, railway, petroleum, electricity, and chemical fertilizer.

A detailed review of the enterprise law and policy under Republican rule is beyond the scope of this study. Suffice it to indicate that the 1929 Company Law, which mainly concerns private businesses and has since been amended several times,³²

²⁷ The dominance of public enterprises on Taiwan actually began in 1945 when the Nationalist Government nationalised all the property and enterprises handed over by the Japanese government and private businesses after Japan's defeat.

²⁸ Such pressure came particularly from the United States which provided financial help to Taiwan on the condition that private economy had to be developed in order to promote its economic development. See Wu, supra note 23, pp.43-4.

²⁹ On Jan.26, 1953, regulations were adopted to transform public enterprises into private enterprises.

³⁰ Of the total industrial output, the percentage accounted by public enterprises fell from 56.6 in 1952 to 18.7 in 1980. See Ye and Qiu, supra note 24, pp.228-9.

³¹ See Ye and Qiu, ibid., pp.244-6; Liu Fengwen and Zuo Hongchou, Gongying Shiye de Fazhan (Development of Public Enterprises), Associated Economy Publishing Company (Taipei), 1984, pp.177-82. Also see Wu, supra note 23, p.46.

³² For a comprehensive review and comments on China's company legislation, see Lai In-Jaw, "Zhongguo Gongsì Lifa Zhi Huigu Yu Qianzhan" (The Chinese Company Law: A Retrospect and Prospect), in Taida Faxue Luncong (The National Taiwan University Law Journal), Vol.13, No.2, 1984, pp.193-230. The

has contributed significantly to the miracle of Taiwan's economic development in the last decades. As will be shown below, the 1946 Republican Company Law did have some impact on PRC legislation in the 1950s. Nevertheless, enterprise laws and policies in the PRC followed a very different path from that taken in the Republic of China before 1949 and that have continued in modified term to be practised in Taiwan since 1949. It should be noted that existing Company Law in Taiwan will certainly influence future company legislation in mainland China, although the likely extent of such influence is not yet clear.³³

II. Socialist Enterprise Laws and Policies in China

The main contents of socialist laws and policies governing state enterprises in China will be discussed in detail in later chapters when specific aspects of the legal regulation of state enterprises are examined. The discussion below intends to provide an outline of enterprise laws and policies from the 1930s until the development of post-Mao "enterprise laws". The main aim of such an outline is to illuminate the development and evolution of Chinese enterprises and relevant governing laws and policies as a whole so that laws and policies concerning state enterprises can be understood in a broader and changing setting.

A. Before 1949

The Chinese Communist Party (CCP) was founded in 1921. In

latest amendment took place in Oct.1990. The main amendments concerned associated enterprises, reinvestment by companies, issue of shares of public enterprises, and employees' shares.

³³ Currently, some areas in Southern China, such as Shenzhen Special Economic Zone in Guangdong Province, are attempting to "transplant" company and commercial legislation from Hong Kong. But legislation from Taiwan would seem more transplantable. This is not only because of the similar civil law background, but also because of the common language shared by mainland China and Taiwan.

the attempt to gain political power, from the late 1920s onwards, many rural "base areas" (genjūdi) were established. In those base areas and so-called "liberated areas" (jiiefangqu), many economic regulations were promulgated for guidance during a particular period. These economic regulations shared two common characteristics. On the one hand, they were basically local documents. Most were promulgated by local Communist authorities and only applicable to limited areas. On the other hand, they were strongly policy-oriented. Although there were some documents entitled "regulations" (tiaoli), it seems that none of those economic regulations took the form of "law" (fa). In fact, most of enterprise regulations were issued as "decisions" (jueding), "orders" (xunling), "outlines" (dagang), and "administrative programmes" (shizheng gangling). They were not only subject to frequent adjustments in accordance with changing political needs, but were also very brief and simple in their content and structure.

Generally speaking, the regulations of various enterprises in this period took the following three forms:

First, there were many general economic policies. The Resolution on Economic Policy adopted by the First Chinese Soviet National Congress in 1931³⁴ was the first important document of this type. It contained three paragraphs concerning industry. First, the Soviet government would nationalise all economic "lifelines" (including concessions, banks, customs, railways and so on) which were held by "imperialists" while allowing some foreign enterprises to reset lease agreements and to continue their operations, provided that they complied with relevant Soviet laws and regulations. Secondly, enterprises and handicraft industry

³⁴ See Zhonghua Suweiai Gongheguo Falū Wenjian Xuanbian (Selected Legal Documents in the Chinese Soviet Republic), Jiangxi People's Press 1984, pp.239-41. For a general introduction of the laws in the Chinese Soviet Republic, see W.E. Butler (ed.), The Legal System of the Chinese Soviet Republic, Transnational Publishers Inc. (Dobbs Ferry, New York) 1983.

owned by Chinese private investors were to be allowed to continue their operations without being nationalised. However, their activities would be placed under the supervision of workers' committees and factory committees. Thirdly, special attention was paid to the development of those enterprises which would guarantee supplies for the Red Army. Thus, this Resolution set out the main economic policy for the period of 1934-1937. During the Anti-Japanese War (1937-1945), many governments in "border areas" (bianqu) adopted administrative programmes which provided for basic political, economic and social principles. For example, the Administrative Programmes of the Shaanxi-Gansu-Ningxia Border Region (May 1, 1941)³⁵ stated that:

developing industrial operation and commercial circulation, rewarding individual business, protecting private property, welcoming investment from other areas, practising free trade, opposing monopoly control, in the meantime developing people's cooperative, and helping the development of handicraft industry.³⁶

From late 1945 to 1949, Communist-controlled areas were gradually enlarged. In order to promote economic development, detailed economic policies were put on the agenda. The Administrative Programmes of the Democratic Government in North-East China (August 11, 1946)³⁷ declared that "individual industry and commerce must be protected, rewarded and helped; public enterprises must be resumed and developed; and cooperative business must be developed".³⁸ Therefore it seems that private, public and cooperative enterprises were stressed equally. There were, however, some policy changes in subsequent years. For example, according to the Administrative Programmes of the People's Government of North China (August

³⁵ See Zhongguo Xinminzhuzhuyi Geming Shiqi Genjüdi Fazhi Wenxian Xuanbian (Selected Legal Documents in Base Areas During the Chinese New Democratic Revolution), Vol.1, China Social Sciences Publishing House (Beijing) 1981, pp.34-7.

³⁶ Art.11, ibid.

³⁷ Ibid. pp.66-8.

³⁸ Ibid. par.4.

1948),³⁹ "any aspect of industry may be, unless otherwise limited by laws and regulations, operated by private enterprises", nevertheless, "state industry should lead private enterprises". Moreover,

The key areas of state industry should be machine-manufacturing, munitions, important industrial material-manufacturing and the chemicals -- medicines industry, and other industries which are urgently needed to support the War or people's livelihood but which are nevertheless impossible or inappropriate for individual business to operate.

State enterprises may lease in the form of state capitalism to individuals or cooperatives to operate those industries and mining which are not possible for state enterprises themselves to run; state industries must according to plans supply necessary machines, raw materials and powers to individual industries and cooperative industries which are beneficial to the national economy and the people's livelihood, and encourage the development of the individual industry and cooperatives.

As a whole these policy declarations, at least for a certain period of time, were no less important as guides to practice than formal laws.

Secondly, there were also certain specific regulations on state enterprises, cooperatives, and private businesses. The Regulations Concerning the Administration of Soviet State-Owned Factories, adopted on April 10, 1934,⁴⁰ was the first legislation adopted to govern state enterprises under Chinese Communist rule. These Regulations contained only eleven articles, but nevertheless covered many issues, including factory leadership, administration of factories, workers' wages and status, director's responsibility and accounting rules.

In addition, on April 22, 1932, the Provisional Central Chinese Soviet Government adopted Temporary Organisational Regulations on Cooperatives.⁴¹ These Regulations declared

³⁹ Ibid., pp.71-85.

⁴⁰ For the text, see supra note 35, pp.289-90.

⁴¹ Ibid, pp.266-7. For an English translation, see Butler (ed.), supra note 34, pp.171-2.

cooperatives to be one of the main ways for developing the Chinese Soviet economy.⁴²

Private businesses were encouraged. In January 1932, the Provisional Central Chinese Soviet Government adopted the Temporary Regulation on Investment on Industrial and Commercial Businesses.⁴³ These Regulations provided that private capital might be invested freely in the Soviet China.⁴⁴ Even state-owned enterprises, mining and forests could be leased through agreements to private businessmen for management.⁴⁵ Investors, however, had to report in advance and in considerably detail to the local Soviet government the amount of capital, company's articles of association or its name, business coverage and names of its directors. After the business certificate had been issued, the company could carry out the stipulated business functions.⁴⁶

Thus, enterprise policies and laws between 1927 and 1949 in Chinese Communist areas were relatively simple and undeveloped. Although private investment was encouraged, the whole structure of company regulations was quite different from either the situation in China before 1927 or that in the Republican Government-controlled areas of the same period. The late Qing rulers imported many commercial laws from Western countries and initiated an era in which the national economy was to be developed by encouraging private companies. In contrast, the Communist government in China began in the early 1930s to import Marxist and Soviet models in constructing its economy. As a result, it relied heavily on state enterprises and cooperatives, and therefore initiated a new era of "socialist enterprise law".

⁴² Art.1, ibid.

⁴³ Ibid., p.265. For an English Translation, see Butler (ed.), supra note 34, p.173.

⁴⁴ Ibid. Art.1.

⁴⁵ Ibid. Art.3.

⁴⁶ Ibid. Art.2.

It should be noted that although socialist policy and law had priority in its application in base areas and liberated areas, there are some indications that Republican laws were also taken into account by some local Communist authorities. In order to eradicate the impact of these laws, in February 1949, the Central Committee of the Chinese Communist Party (CCP) issued an "Order on Abolishing All Guomindang Laws and Establishing Judicial Principles in Liberated Areas".⁴⁷ The Order stipulated that all Guomindang laws would be totally abolished in liberated areas and therefore pushed the socialist nature of Chinese law to an extreme point. The Order particularly stated that

People's judicial work should be based on people's new laws. Because people's laws are not complete, the working principles of judicial organs should be: follow guiding principles' (gangling), laws' (falü), orders' (mingling), regulations' (tiaoli), and resolutions' (jueding) when they are present; and follow new democratic policies' (xinminzhuzhuyi zhengce) when guiding principles and so on are absent.

This Order had very deep implications for the subsequent development of the PRC legal system. As will be shown below, law had since been placed at a relatively subordinate position and policies had always played a very active and extremely important role. To a great extent, the over-reliance on policies was an excuse for the neglect of law, at least until the late 1970s.

B. 1949-1978

1. 1949-1956

The PRC was formally established on October 1, 1949. Subsequently, the government devoted itself to building a socialist economy in which public ownership would occupy a central position.

The economic structure established before 1949 in mainland China was, according to the Communist view, basically

⁴⁷ See the text in Chinese, supra note 35, pp.85-7.

composed of four kinds of property: property held by "foreign imperialists"; "bureaucratic capital" (guanliao ziben) held by the Republican government and powerful officials; "national capital" (minzu ziben) held by the national bourgeoisie; and an individual economy which included activities such as the handicrafts industry. The PRC government adopted different policies towards different types of enterprise.⁴⁸ First, enterprises owned by "imperialists" and "the bureaucratic bourgeoisie" were to be confiscated and converted into socialist state-owned enterprises. This process had actually taken place even before 1949 in the "liberated areas". It was also declared, by the time of the foundation of the PRC in 1949, the new government had already successfully controlled national economic lifelines and made the state-owned economy the leading component of the national economy.⁴⁹ Nevertheless, the confiscation of "imperialist property" continued after 1949. In 1952, the Central People's Government promulgated "Measures on Rectification of Government Shares and Properties in Enterprises".⁵⁰ The Measures furthered the rectification and subsequent confiscation of properties held in a concealed form by the former Republican government in private enterprises. By 1951, such confiscation almost ended. Socialist state ownership was firmly established.

⁴⁸ These arrangements were also reflected in the Common Programme of the Chinese People's Political Consultative Conference of September 1949, which acted as a provisional constitution for several years until the introduction of a formal Constitution in 1954.

⁴⁹ See Zhu Jiannong, Zhongguo Shehuizhuyi Suoyouzhishi Wenti Yanjiu (Research on the Problem of Chinese Socialist Ownership), People's Publishing House 1985, pp.19-20.

⁵⁰ Promulgated on Jan.5, 1951, see Siying Gongshangye De Shehuizhuyi Gaizao Zhengce Faling Huibian (Collection of Policies and Laws on the Socialist Reform of Private Industry and Commerce, 1949-1952), Finance and Economy Publishing House (Beijing) 1957, Vol.1, pp.111-6.

Secondly, national capital was to be peacefully redeemed⁵¹ and then gradually transformed into public ownership. While bureaucratic capital constituted eighty per cent of the former Republican economy, national capital accounted for only twenty per cent of the Republican economy.⁵² In view of the facts that national economy was recovering from the War Against the Japanese and the Civil War, and that state enterprises could only form a part of the national economy, the new government decided to allow national capital to exist. But national capital had to be restricted on the ground that private investors were accused of exploiting employees. The Common Programme of the Chinese Political Consultative Conference, which was adopted in September 29, 1949 and employed as a temporary state constitution until 1954, provided:

The cooperative economy of state capital and private capital is state-capitalist economy. Under necessary and possible conditions, private capital should operate in the direction of state-capitalism, for example, processing for state enterprises, operating joint state-private ventures with, or managing state enterprises and exploiting rich resources of the state in the form of leasing.⁵³

In the summer of 1953, the reform of "capitalist industry and commerce" began. The 1954 Constitution set out the basic policy in this reform:

⁵¹ The Chinese authority declared that the peaceful redemption of national capital was a great victory as no violence was engaged in the process of expropriation. Actually, the redemption was, as even the Chinese authority admitted, opposed by the capitalists. Here, "redemption" did not mean that the state gave especially a certain amount of money to capitalists. Rather, by the form of state-capitalism, the state gave capitalists an opportunity to exploit (usually without their own labour) the people. This opportunity which were practised in many ways such as the sharing of dividends and interests by capitalists was the price of redemption. See Zhu, supra note 49, pp.27-38.

⁵² The number of private industrial enterprises backed by national capital was about 123,000, and 1,640,000 workers were employed. Information from Zhu, supra note 49, p.25.

⁵³ See Art.31.

The state protects the right of capitalists to own the means of production and other capital according to law.

The policy of the state towards capitalist industry and commerce is to use, restrict and transform them. By way of government administration, the leadership of the state sector of the economy, and the supervision by workers and the masses, the state makes use of positive functions of capitalist industry and commerce which are beneficial to national welfare and the people's livelihood, restricts their negative functions which are harmful to national welfare and the people's livelihood, encourages and guides their transformation into various form of state-capitalist economy, and gradually replaces capitalist ownership with the ownership by the whole people.

The state forbids capitalists from engaging in unlawful activities which harm the public interest, disrupt social-economic order, or undermine state economic plans.⁵⁴

Thirdly, reform of the individual non-agricultural economy took a different process from that of either bureaucrat or national capital. The individual economy was basically regarded to be non-exploitative as individual businessmen supported themselves with their own labour. Nevertheless, the individual economy had since 1949 been on the agenda of reform because at that time the individual economy was also thought to be against socialist public ownership. The aim of the reform was set to lead individual businessmen to move to collective ownership by way of cooperatives. In 1952, a plan was drawn up to realise the collectivisation of individual non-agricultural economy in a period of fifteen years or more. The 1954 Constitution confirmed this transition:

The cooperative sector of the economy is either socialist, when collectively owned by the working masses, or semi-socialist, when in part collectively owned by the working masses. Partial collective ownership by the working masses is a transitional form by means of which individual peasants, individual handicraftsmen, and other individual working people organise themselves in their advance towards collective ownership by the working masses.

The state protects the property of the cooperatives, encourages, guides and helps the development of the

⁵⁴ Art.10.

cooperative sector of the economy. It regards the promotion of producers' cooperatives as the chief means for the transformation of individual farming and individual handicrafts.⁵⁵

In late 1955, the reform of handicrafts cooperatives was attacked on the ground that it was too slow. Soon after, the socialist reform of handicrafts economy was virtually completed within just a few months -- rather than the fifteen years or more originally suggested.⁵⁶

The period of 1951-1978 saw a shift in the national policy towards individual economy. The trend was towards a significant decline in the importance of the individual economy.⁵⁷ The crucial element underlying the policy shift was an emphasis on the property ownership. Public ownership, especially state ownership, was considered the ideal form for a socialist economy. The individual economy had to be transformed as quickly as possible to collective or state ownership. On the other hand, individual property and interests were thought to be totally alien to socialist economy, and were labelled as "capitalist tails" (ziben zhuyi weiba) which had to be eliminated for a socialist economy.

During this period of transformation in the Chinese economy, the co-existence of policy and law was the basic framework within which all forms of enterprises had to operate. Policies played a very important role, especially in relation to state enterprises. "Directives" (zhishi) were the principal manifestation of policies. On February 28, 1950, the Commission on Finance and Economy under the Government Administration Council (GAC) issued a Directive on

⁵⁵ Art.7.

⁵⁶ By the end of 1956, 91.7 per cent of all handicraftsmen had been collectivised, with a total output of 7,600 million Yuan -- about per cent of national handicrafts' output. See Zhu, supra note 49, p.66.

⁵⁷ For a detailed description, see Liu Hong and others, Zhongguo Xianjieduan Geti Jingji Yanjiu (Studies on the Present Chinese Individual Economy), People's Press (Beijing) 1986, pp.16-9.

Establishing Factory Management Committee in State-Owned and Public Factories.⁵⁸ This Directive, by reinforcing and extending nationally the Implementing Regulations on Establishing Factory Management Committees and Workers' Congresses in State-Owned and Public Factories issued by the People's Government of North China on August 10, 1949, ordered that factory management committees be established in order to practise democratisation of management.⁵⁹

There were also policies regarding the registration of enterprises. On March 30, 1951, the Commission on Finance and Economics under the GAC issued a Directive ordering all public and joint state-private enterprises to register with the

⁵⁸ For the text in Chinese, see Laws and Regulations of the PRC Central Government (1949-1950), pp.453-56. Here "public factory" (gongying gongchang) was an abandoned usage referring to a factory owned and managed by a province or county (including state organs and army). These "public factories" used to be also called "local industries" (difang gongye), in contrast to "state-owned industries" (quoying gongye) owned and managed by a government or military region above provincial level. Sometimes state-owned factories and public factories were jointly named "public industries" (gongying gongye), in contrast to "private industries" (siying gongye). (For a further observation on this distinction, see Zhu Jianhua (ed.), Dongbei Jiefanqu Caizheng Jingji Shigao (A History of Finance and Economy in North-East Liberated Areas), Heilongjiang People's Press 1987, footnote at p.206.) The confusion was, however, sorted out in the Stipulations about the Usages of Names of State Enterprises Etc issued by the Government Administration Council on Sept.2, 1952 (see the text in Chinese, in Laws and Regulations of the PRC Central Government (1952), p.112). These Stipulations pointed out that from then on the term "state enterprises" (quoying qiye) should be used to refer to enterprises invested in and managed by the Central Government and departments of large administrative regions, including those entrusted by an administrative region to a province or city to manage. Enterprises invested in and managed by governments under provincial level should be called "local state enterprises" (difang quoying qiye).

⁵⁹ This was also provided in Art.32 of the Common Programme of the Chinese People's Consultative Conference (September 1949).

competent authorities.⁶⁰ Soon after, on May 4, 1951, a supplementary directive was issued by the same Commission on the registration of public and joint state-private enterprises.⁶¹

Although policies were a very important source for norms governing enterprise matters during that time, it was also understood by the PRC leadership that formal laws and regulations could be used to encourage economic development. Since the laws of the Republic of China were abolished in the PRC from late 1948 onwards, there was a short period when no appropriate laws applied. In particular, the legal status of private companies, which had been registered under Guomindang laws and survived in the newly-established state of the PRC, remained uncertain. In order to free private investors of their apprehensions and to encourage the development of private enterprise, the Central Bureau on Private Enterprises under the GAC began in April 1950 to draft the provisional regulations on private enterprises. At the same time, the Legal Bureau under the GAC was also engaged in drafting a new company law, but this law was never published. Instead, on December 29, 1950, Provisional Regulations on Private Enterprises (hereinafter "Regulations") were adopted and promulgated by the GAC. The Regulations applied not only to companies but also to sole traders and to partnerships. Three months later, on March 30, 1951, the Commission on Finance and Economy, promulgated the Implementing Measures for the Regulations. Thus, the Regulations, together with the Implementing Measures, constituted a relatively comprehensive legal treatment of private enterprises. On the one hand, there

⁶⁰ See the text in Chinese, in Selected Enterprise Laws and Regulations, p.141. Here "competent authority" meant either county administrative organs in charge of industry and commerce or the Commission on Finance and Economy itself when an enterprise was a "company" (gongsi) or it was to be under direct control of a central ministry.

⁶¹ Ibid. pp.141-2. The contents for registration were listed as: name of the enterprise, business coverage, place of the enterprise, organs in charge of the enterprise, date of its formation, "references" (beikao) and other particulars.

was an inseparable continuity between the old Republican laws and the new law on private enterprises. Not only were sole traders and partnerships permitted but also five forms of companies, as provided in the Republican Company Law, were given official endorsement.⁶² The Regulations also provided that enterprises approved prior to the introduction of the Regulations would continue to operate unless otherwise provided in law.⁶³ These enterprises "must register with competent local or central authorities", but those which had already registered with local administrative organs of industry and commerce and which have been kept in registration files were not required to register again.⁶⁴

On the other hand, the Regulations also introduced some new measures. First, registration procedures were strict. All new private enterprises had to be approved before registration.⁶⁵ The main purpose of this compulsory procedure was described⁶⁶ as the protection of the interests of investors and to prevent "blind" (mangmu) development of private enterprises. In fact, this procedure, by putting limitations on free enterprises, enabled the state to control effectively, and to limit the number and the scale, of private enterprises.

Secondly, state economic planning was put on the agenda.

⁶² During the drafting of the Regulations, it was suggested to keep only three of the five company forms, ie. company limited by shares, unlimited company, limited liability company. But it was vetoed as first, more choices should be left to investors: and secondly, a change in company forms would mean reorganisation of previously-formed companies and therefore add more difficulties. See Xue Muqiao (Director of the Central Bureau on Private Enterprises), "Siying Qiye Qicao Jinguo Jiqi Shuoming" (Drafting Process of and Explanation on Provisional Regulations on Private Enterprises), in Siying Gongshangye Shehuizhuyi Gaizao Faling Xuanbian, supra note 50, pp.95-6.

⁶³ Art.13.

⁶⁴ Ibid.

⁶⁵ Art.11.

⁶⁶ Art.11.

The Regulations provided:

In order to prevent "blind" (mangmu) production, to adjust relationships between production and selling, and gradually to transform our economy into a planned economy, the government may when necessary make plans for production and selling of some important commodities. Both public and private enterprises have to comply with these plans.⁶⁷

Thirdly, distribution of profits had to follow compulsory procedures. According to the Regulations, the profits of sole traders or partnership could be distributed in accordance with either law, contract, or professional customs. In contrast, the profits of companies had to be distributed in accordance with the procedures provided by the Regulations.⁶⁸ These compulsory arrangements for the distribution of profits were mainly meant to restrict "exploitation" by the owners of private enterprises. Last, but not least, labour protection was stressed. Article 7 provided that enterprises had to implemented sincerely all labour laws and regulations promulgated by the government. These features of the Regulations represented a new philosophy in enterprise law, a compromise between old capitalist law and new socialist law. Accordingly, an editorial carried in People's Daily⁶⁹ pointed out that the new law was a document setting out the relations between several types of economic element and between several "classes".

Although the Regulations were characterized as

⁶⁷ Art.6.

⁶⁸ According to Art.25 of the Regulations, the procedures for the distribution of the profits were: (1) paying income taxes and making up losses; (2) devoting ten per cent towards as accumulation funds for the purpose of expanding business and safeguarding future losses; (3) distributing dividends for shareholders and providing remuneration for directors, supervisors and managers; (6) setting aside a welfare fund and a "reward fund" for employees; and (7) other purposes.

⁶⁹ Jan.17, 1951, p.1.

"provisional",⁷⁰ they have been very important in the legal history of the PRC. The Regulations were the first major item of enterprise legislation to be introduced after 1949. In addition, although the Regulations were concerned with private enterprises, some of the principles embodied in the Regulations were actually applicable to other types of enterprise as well. In fact, the Regulations made express reference to state and state-private enterprises, to such matters as "joint businesses" (lianying),⁷¹ and to the need for compliance with state economic plans.⁷² On the other hand, the provisions in Regulations concerning enterprise registration were referred to as applicable to state and state-private enterprises. The two Directives issued by the Commission on Finance and Economy under the GAC in March and May 1951, as mentioned above, all required that both state and state-private enterprises should register according to the provisions in the Regulations.

Private enterprises, although having some new features, were still regarded as "capitalist" in nature under the Regulations. As a result, they had to be more radically transformed in the direction of socialism. While the 1950 Regulations were not replaced by a subsequent Private Enterprise Law as had been originally planned, they were made marginal by the Provisional Regulations on State-Private Industrial Enterprises (hereinafter "Provisional

⁷⁰ When the Regulations were passed, it was genuinely thought that they were going to be amended within two or three years, and then superseded by a comprehensive "Private Enterprise Law". See Xue, supra note 62, p.102. But the plan was not carried out until the new "Provisional Regulations on Private Enterprises" in 1988. It is interesting to note that both were characterised as "provisional". Actually they are not exceptions to Chinese law where many laws and regulations are simply termed "provisional". But not even legislators can know how long a "provisional" tag will stand. The word "provisional" which itself reflects a controversial and uncertain nature of the subject makes the subject open to subsequent political, economic or social changes.

⁷¹ Art.5.

⁷² Art.6.

Regulations"),⁷³ adopted by the GAC on September 2, 1954. The Provisional Regulations defined a state-private industrial enterprise as an "industrial enterprise which is invested in by the state or by another state-private enterprise and which is jointly ~~operated~~ operated by state-appointed cadres as well as by capitalists".⁷⁴ The principle for the formation of such enterprises was described as "in accordance with the state's needs, the possibility of reforming the enterprise concerned, and capitalists' willingness to cooperate".⁷⁵ In principle, "the legal interests of private shares are to be protected", but "socialist elements shall occupy leading position".⁷⁶ These enterprises were to be jointly managed by government officials and private investors, and were put under direct government control.⁷⁷ The government was empowered not only to decide important issues which could not be resolved in enterprises⁷⁸ but also to hear and approve board of directors' reports over important decisions.⁷⁹

The administrative positions of representatives from both the state and private investors were to be decided by negotiations between the government and private investors.⁸⁰ Workers were given the opportunity to participate in enterprise management.⁸¹ Enterprises had to implement state

⁷³ Although the Provisional Regulations specified that they were applicable to "industrial enterprises" only, it was nevertheless provided in Art.26 that the Provisional Regulations also applied to state-private enterprises in the areas of transportation and construction.

⁷⁴ Art.2.

⁷⁵ Ibid.

⁷⁶ Ibid. Art.3.

⁷⁷ Art.23.

⁷⁸ Art.10.

⁷⁹ Art.19.

⁸⁰ Art.11.

⁸¹ Art.13.

plans,⁸² and to learn from state enterprises in making decisions concerning wages and welfare while taking into account their own special situation.⁸³ In addition, they had to follow government instructions on such matters as production, management, accounting, labour, safety and health.⁸⁴ The Provisional Regulations also provided compulsory rules for the distribution of profits.⁸⁵

Generally speaking, the Provisional Regulations set out the basic structure of, and defined relations within, state-private enterprises. It was assumed from the beginning that private investors had the right to participate in the management of such enterprises. Nevertheless they were subject to extensive government control. In reality, private investors possessed little bargaining power, and had to accept the rules provided in the law, and the orders and instructions of the government.

Like the Regulations, the Provisional Regulations were intended as a purely interim item of legislation. As noted above, the transformation of capitalist industry and commerce was completed so quickly that the Provisional Regulations survived for less than two years. After the state-capitalization of all industries in 1956, private investors could still hold high positions and participate in enterprises' management, but their capital incomes (excluding wages) were no longer connected with the operation of enterprises in which they had invested. Instead, they were given only "dividends" at a fixed rate for their capital investment. The Provisional Regulations were made obsolete, because private investors had lost their rights of control which had originated in their investment in enterprises. Like state enterprises, state-private enterprises were put under

⁸² Art.4.

⁸³ Art.14.

⁸⁴ Art.15.

⁸⁵ Arts.17 and 18.

extensive government control. In September 1966, the Chinese government decided to cease the payment of dividends to private investors. Henceforth, joint state-private enterprises were state enterprises.

2. 1957-1978

From the late 1950s onwards, with the gradual disappearance of private enterprises, public ownership enterprises came to be the only official form of enterprise. Until the late 1970s, no formal legislation was adopted to govern enterprises. For state and collective enterprises, only a few policy-oriented documents were promulgated.

On November 15, 1957, the State Council -- successor to the GAC -- promulgated "Provisions on Improving Industrial Administration System".⁸⁶ These provisions were aimed at reforming the highly-centralised administration system by giving local governments and enterprises managers more powers. The incentives and measures contained in these Provisions were sound, but were soon drowned by the so-called "Great Leap Forward" beginning in 1958. During the campaign of the "Great Leap Forward", many collectively-owned enterprises were suddenly converted into state-owned enterprises -- collective ownership was officially thought to be a lower degree of public ownership. In rural areas, all the property previously owned by cooperatives were changed to the ownership of commune -- itself suspected of being state or collectively-owned in nature.⁸⁷ This rash advance was temporarily stopped subsequently. In 1961, the Central Committee of the Chinese Communist Party (CCP) issued "Provisions on Some Policy Problems Concerning Handicrafts Industry in Cities and Countryside (Tentative Draft)." These Provisions ordered some state-owned factories which had been wrongly transformed from cooperatives to revert to cooperative form. Moreover, the

⁸⁶ These provisions had been approved by the Standing Committee of the NPC. See the text of these provisions in Chinese, Selected Enterprise Laws and Regulations, pp.37-43.

⁸⁷ See Zhu, supra note 49, p.110.

"Regulations on the Work of Rural People's Communes (Amended Draft)" confirmed collective ownership of communes. It was held that people's communes should carry out the economic system of "three ownerships," that is, "ownership by the commune, the production brigade and the production team, with the production team as the basic accounting unit" (sanji suoyou, duiwei jichu).

The "Great Leap Forward" came to an end in 1960, but this campaign had deep implications for the subsequent development of the Chinese economy. Collective enterprises continued to exist, but they had to be managed in almost the same way as state enterprises. The government could freely insist on "equalitarianism, and indiscriminate transfer of resources" (yiping erdiao) between collective and state enterprises. To some extent, collective enterprises themselves were happy with the extensive government control that then entailed, and many even attempted to keep up with state enterprises on important issues such as production and selling, the leadership system, workers' wages and welfare. Indeed, copying state enterprises was often the only way for a collective enterprise to survive the accusation of having "private" elements. Thus, there were not many differences between collective and state enterprises.

One important document worthy of note here is the "Regulations Concerning the Work of State Industrial Enterprises (Draft)"⁸⁸ issued by the CCP Central Committee on September 16, 1961. These Working Regulations confirmed the system of director responsibility under the leadership of the Party committee and the system of workers' congress, both arrangements having already been announced in 1956.⁸⁹ It was valid until the Cultural Revolution, which not only affected politics and society but also seriously undermined the operation of enterprises. In fact, during the Cultural Revolution (1966-1976), no formal legislation was adopted for

⁸⁸ See the text in Chinese, Selected Enterprise Laws and Regulations, pp.45-73.

⁸⁹ For a discussion, see Chapters Six and Seven below.

the regulation of state enterprises which, as a rule, were directly managed by the government and its departments.

III. Economic Reforms and Enterprise Laws

A. Revival of the law

The Chinese economic reforms started in the late 1970s. From the very beginning of the reforms, the Chinese leadership turned its attention to the potential role of the law. As early as December 1978, in his famous speech entitled "Emancipate the Mind, Seek Truth From Facts and Unite as One in Looking to the Future",⁹⁰ Deng Xiaoping pointed out the necessity of using laws and regulations to govern the economic reforms. In particular, Deng raised the issue of "economic democracy" which focused on the delegation of decision-making powers to various units, including state enterprises. He further indicated that, in order to ensure such democracy, China's legal system should be strengthened.

Democracy has to be institutionalised and written into law, so as to make sure that institutions and laws do not change whenever the leadership changes, or whenever the leaders change their views or shift the focus of their attention.⁹¹

Thus, in Deng's view, one of the major advantages of law is its stability and continuity. This feature makes the law more reliable and valuable than policies which are changeable from time to time.

In order to build a sound legal system for China's modernisation, Deng suggested that many laws should be

⁹⁰ See the text, in Selected Works of Deng Xiaoping (1975 -- 1982), Foreign Languages Press (Beijing) 1984, pp.151-65. This speech served as the keynote address for the Third Plenary Session of the Eleventh Central Committee of the CCP that immediately followed and formally initiated the post-Mao economic reforms.

⁹¹ Ibid., pp.157-58.

enacted.⁹² As far as enterprises were concerned, not only management autonomy but also management responsibility had to be provided for by law to enterprises, their managers and relevant persons. To achieve this aim, Deng emphasized that

the relations between one enterprise and another, between enterprises and the state, between enterprises and individuals, and so on should also be defined by law, and many of the contradictions between them should be resolved by law.⁹³

Following Deng's instructions, for the first time in the history of the PRC, enterprise legislation has been carried out on an impressively large scale.

B. Development of "enterprise laws"

1. Overall view

As indicated in Chapter One above, the major laws and regulations which have been adopted since 1979 are: the Law on Equity Joint Ventures (1979), the Law on Wholly Foreign-Owned Enterprises (1986), the Law on Cooperative Joint Ventures (1988), Provisional Regulations Concerning Private Enterprises (1988), the State Enterprise Law (SEL) (1988), Regulations Concerning Rural Collective Enterprises (1990), and Regulations Concerning Urban Collective Enterprises (1991). In addition, the Enterprise Bankruptcy Law (EBL) was adopted in

⁹² The laws mentioned in his speech included: criminal and civil codes, procedural laws and other necessary laws concerning factories, people's communes, forests, grasslands and environmental protection, as well as labour laws and a law on investment by foreigners. According to Deng, "legal provisions will have to be less than perfect to start with, then be gradually improved upon. Some laws and statutes can be tried out in particular localities and later enacted nationally after the experience has been evaluated and improvements have been made. Individual legal provisions can be revised or supplemented one at a time, as necessary; there is no need to wait for a comprehensive revision of an entire body of law. In short, it is better to have some laws than none, and better to have them sooner than later." Ibid., p.158. These remarks have had profound impact on post-Mao legislation.

⁹³ Ibid., p.158.

1986 and came into force in 1988.

The development of "enterprise laws" in the PRC has two basic features. The first is that, legislation has been carried out with apparently more and earlier success in relation to foreign investment enterprises than in relation to domestic enterprises. This fact illustrates the existence of considerable difficulties facing the legislation on domestic enterprises in the reform era. Furthermore, this fact reflects different attitudes of the Chinese policy-makers towards different enterprises. While laws and regulations have to be promulgated as soon and comprehensive as possible to protect the rights and interests of foreign investors, policies may remain as the main source for governing and guiding domestic enterprises.⁹⁴ The delay of legislation concerning domestic enterprises has been particularly obvious where there is notable policy uncertainty in the process of reforms. Harsh legislation is widely considered to be inappropriate, irresponsible, and difficult to implement.⁹⁵

Another noteworthy feature of contemporary Chinese enterprise law is that enterprise legislation has been carried out in the light of the system of property ownership. In 1979 when a factory law began to be drafted, it was suggested that the law should be applicable to all enterprises, regardless of their property ownership. However, many people were worried about the difficulties in drafting a law of such a broad

⁹⁴ This has been underscored by the fact that detailed regulations have been promulgated by Chinese authorities for implementing laws governing foreign investment enterprises. Such examples include the Implementing Regulations Concerning the Law on Equity Joint Ventures (promulgated on Sept.20, 1983), Implementing Rules Concerning the Law on Wholly-Foreign-Owned Enterprises (promulgated on Dec.12, 1990). Whereas for Chinese domestic enterprises, only Provisional Regulations Concerning Private Enterprises have been followed by the Implementing Measures. Comprehensive Implementing Regulations for the SEL have failed to be promulgated. For a discussion, see Chapter Ten of this study.

⁹⁵ Nevertheless, in some cases, legislation may be adopted under the pressure from the central leadership. This was the case for the EBL which was adopted despite great opposition and the absence of the SEL. See Chapter Eight.

application.

Subsequently, laws governing foreign investment enterprises were differentiated. In order to attract foreign investment, the Law on Sino-Foreign Equity Joint Ventures was promulgated in 1979. Subsequently, in October 1980, it was decided by the National People's Congress that a law governing state enterprises should be given priority and separate treatment.⁹⁶ Since then, many laws have been drafted and adopted on the basis that enterprises of different property ownership shall apply different laws and regulations.⁹⁷

⁹⁶ For a discussion of this development, see Yang Zixuan (ed.), Gongye Qiyefa Jiaocheng (Textbook on Industrial Enterprise Law), Law Press 1986, p.19.

⁹⁷ It should be noted that since the mid-1980s, this way of enterprise legislation has caused increasing concern among Chinese scholars. One of their greatest worries is the overlap among, and inconsistencies between, different enterprise legislation. In addition, the existing methods of enterprise legislation is widely seen as blocking the way for future company legislation. For a discussion, see Li Cheng, "Xianxing Qiye Fenlei Fangfa Yu Gongsi Lifa" (Current Methods for Classifying Enterprise and Company Legislation), in FXPL, No.4, 1990, pp.14-7. Also see Zhao Xudong, "Zhongguo Gongsi Lifa de Jige Wenti" (Several Issues Concerning Chinese Company Legislation), ZFLT, No.1, 1991, pp.38-43 & p.67.

Many Chinese scholars have advocated the idea of classifying enterprises and making laws on the basis of the "legal forms" (falü xingshi). In other words, the criterion for deciding whether an enterprise is subject to a particular law should be whether the enterprise is a "sole trader" (duzi), a "partnership" (hehuo), or an "company" (gongsi). Such an attempt, if implemented, would bring the legislative structure of Chinese enterprises in line with Western practices. However, as this suggestion ignores the importance of property ownership, and as limited companies are still in a stage of experimentation, it remains to be seen whether or not this attempt will fit the Chinese case. Also see the discussion in Chapter Ten below concerning the future prospects of enterprise law.

2. Difficulties in enacting the SEL⁹⁸

Compared to the rapid and comprehensive legislation on foreign investment enterprises, the enactment of the SEL was rather complex and time-consuming. The SEL, from its conception in 1979 to its formal adoption in 1988, took a total of ten years. It also experienced the greatest publicity of any law in the legislative history of the PRC. The most controversial issue complicating the enactment of the SEL was the enterprise leadership system -- an issue to be examined in some detail in Chapter Six of this study.

In response to Deng's call in late 1978 for the enactment of a factory law, the Law Committee under the Standing Committee of the NPC took the initiative in early 1979 to draft an enterprise law. After two years of preparation, in September 1981, the draft law was put forward to the State Council for deliberation. At that time, the reform of the enterprise leadership system had just started. The new director responsibility system was at a stage of initial experimentation. Many of the old structures, especially the system of the director responsibility under the leadership of the Party committee, still prevailed in most state enterprises. In these circumstances, the State Council decided to publish the proposed law as ^{provisional} regulations. Subsequently, in April 1983, the Provisional Regulations Concerning State Industrial Enterprises were adopted by the State Council. And the old enterprise leadership system was upheld.

By the end of 1983, the Central Committee of the CCP called for the reform of the leadership system in more enterprises. This call led to a new period in the process of the drafting of the SEL. In May 1984, the Central Committee of

⁹⁸ For a detailed description of this process, see Section of Enterprise System under the State Commission for Restructuring Economic Systems, and Office of Guidance Committee on Enterprise Management under the State Council, Zhongguo Qiye Gaige Shinian (Ten Years of Enterprise Reform in China), Reform Press (Beijing) 1990, pp.443-45.

The legislative process of the Enterprise Bankruptcy Law will be briefly discussed in Chapter Eight of the thesis.

the CCP decided that the director responsibility system was to be implemented. As a result, more cities and other areas were chosen for experimenting with the new system.

In January 1985, the draft SEL was for the first time presented to the Standing Committee of the NPC for deliberation. From then on until early 1988, the Standing Committee of the NPC deliberated the draft SEL four times, but failed to agree on the suitability of the draft law. In particular, members of the NPC Standing Committee were concerned with the status of both Party committees and managers.

In order to pave the way for an early adoption of the SEL, the Chinese authorities made a number of efforts. These efforts included the promulgation in 1986 of three sets of policy regulations respectively concerning directors, Party committee, and workers' congresses within state enterprises,⁹⁹ and the adoption in late 1986 of the EBL.¹⁰⁰

On January 11, 1988, the Standing Committee of the NPC made an unprecedented move in the legislative history of the PRC by ordering the publication of the draft SEL for public solicitation and discussion. The draft law which was published in major official newspapers attracted extensive attention from enterprise managers, economists, lawyers, and many ordinary people. They not only showed their support for the earlier adoption of the SEL, but also made many suggestions for improving the draft SEL. Finally, by taking into consideration some of the suggestions expressed from the public, the NPC officially adopted the SEL on April 13, 1988.

The long and disputed process by which the SEL was produced reflected the enormous difficulties encountered in Chinese state enterprise reform. The formal adoption of the SEL in 1988 temporarily put an end to ten years of controversy and uncertainty. However, as will be shown in this study, many

⁹⁹ See the discussion in Chapters Six and Seven.

¹⁰⁰ To a certain extent, the premature birth of the EBL was used as a strategy for forcing the early adoption of the SEL. See the discussion in Chapter Eight.

fundamental problems facing state enterprise reform have not been radically addressed and properly solved.

C. Classification of state enterprises and the law

In the West, state enterprises have, with few exceptions,¹⁰¹ not been formally classified by law. Nonetheless, in academic discussions, one widely accepted method of classifying public enterprises is represented both by the different forms which state enterprises take and by the different degrees of government control and consequential autonomy of enterprises. According to this approach, a public enterprise may be placed into one of three categories: first, departmental undertakings operated by a government department with finances and accounts at least partly integrated with those of the government; secondly, public corporations operating under specific legal provisions which provide that enterprises are wholly-owned by the government, or their control is to be exercised in certain ways; and thirdly, companies established under the company law of the country concerned in which the government owns significant shares to ensure control.¹⁰²

If this approach of classification is applied, Chinese state enterprises should be categorized from a developmental point of view. Before the post-Mao economic reforms, state enterprises were directly managed by government departments. As such, all state enterprises of that time might be put into

¹⁰¹ One such exception is Canada which attempted to classify public corporations by statute (e.g. Financial Administration Act 1951) for certain specific purposes. For a discussion on the merits and demerits of such classification, see W. Friedmann and J.F. Garner (ed.), Government Enterprise, Stevens & Sons (London) 1970, pp.204-6.

¹⁰² See R.P. Short, "The Role of Public Enterprises: an International Statistical Comparison", in R.H. Floyd, C.S. Gray and R.P. Short, Public Enterprises in Mixed Economies, IMF Washington 1984, p.112. Also see Henry Parris, Pierre Pestiean and Peter Saynor, Public Enterprise in Western Europe, Croom Helen (London) 1987, p.23.

the first category, that is, departmental undertakings." However, as a result of the post-Mao economic reforms, with the proposed separation of government administration from enterprise management, state enterprises have been granted with legal personality and with relative autonomy which is at least nominally guaranteed by law. Thus, except for a few enterprises which could be labelled as departmental undertakings because of their close resemblance to government departments,¹⁰³ most state enterprises in contemporary China fall into the second category. In other words, they are public corporations operating under special legal provisions -- in particular, the SEL. As for the third category of public enterprises, China is experimenting with shareholding companies. Some companies which are controlled by the state on the basis of equity participation are comparable to public companies of the third category prevailing in the West, but such companies are still few in number.¹⁰⁴

This study is mainly concerned with state enterprises of the second category, that is, state enterprises which are independent entities, not organised under ordinary company law, and closely associated with government departments.

In the Chinese context, one useful mode of classifying state enterprises is to divide them into large, medium, and small-size on the basis of their production capacity and the value of the fixed property held by the enterprises concerned.¹⁰⁵ Although the SEL applies to all state

¹⁰³ One of such example would be China International Trust and Investment Corporation (CITIC). This company has been formed mainly to handle foreign investment issues, including investing in joint ventures. It is put under the direct control of the State Council.

¹⁰⁴ Until the end of 1991, there were a total of 2,300 shareholding companies. And this number include companies which were not controlled by the state.

¹⁰⁵ The production capacity should be regarded as a more important criterion. The value of the fixed property, as a second choice, can only be used for those state enterprises "whose coverage of productions is too broad to be classified in terms of their production capacity". For a report, see RMRB

enterprises, the classification of state enterprises in terms of their size has special legal implications for the enterprises in question. For example, the rates of income tax differ in accordance with the size of state enterprises.¹⁰⁶ Moreover, state enterprises of different sizes may also be put under different legal regimes governing the ways for carrying out corporate management. For example, while small-sized state enterprises may be leased out to for management, large and medium-sized state enterprises must be operated under the "contracting" or chengbao system.¹⁰⁷

Another category of criterion adopted by the Chinese government for classifying state enterprises is the nature of production or services. Under this approach, state enterprises can be classified into industrial enterprises, commercial enterprises, transportation enterprises, foreign trade enterprises, and many other types of enterprises. The SEL, as its full name suggests, is mainly concerned with state industrial enterprises. Nevertheless, it is expressly provided in the SEL that

the principles contained in this Law shall apply to enterprises owned by the whole people which engage in communications and transportation, post and telecommunications, geological prospecting, construction and installation, commerce, foreign trade, the supply of materials and goods, agriculture and forestry, and water conservation.¹⁰⁸

To a certain extent, it is difficult to understand why the Law was not simply called "State Enterprise Law", rather than the present "State Industrial Enterprise Law".¹⁰⁹ The only

(overseas edn.), Sept.18, 1991, p.3.

¹⁰⁶ See Chapter Five of the thesis. Recently, there is a tendency to unify the tax treatment for all enterprises.

¹⁰⁷ For a specific discussion on the chengbao system and a comparison between the chengbao system and the leasing system, see Chapter Nine below.

¹⁰⁸ Art.65.

¹⁰⁹ One prominent professor of Chinese law once informed me that he himself felt "ridiculous" when he was asked to co-author a book entitled "State Industrial Enterprise Law".

reasonable explanation for this may be that industrial enterprises constitute the most important part of the national economy and have taken the lead in the urban economic reform programmes initiated in 1984.¹¹⁰ For the purpose of this thesis, the discussions are concerned with state industrial enterprises unless otherwise stated.

IV. Conclusion

In the PRC, comprehensive enterprise legislation has been possible since 1979 as China started its economic reforms. Before 1979, legal regulation of enterprises was occasionally attempted. Policies and informal documents prevailed in the administration of enterprises. Even adopted regulations were easily made obsolete by policy changes.

To a great extent, the inactivity of law meant the large absence of binding legal norms to the behaviour of enterprises and their managers. As a result, the national economy suffered, for responsibility could not be attached to anyone.

Given the past experience, grave shadow must be cast on the post-Mao economic and legal reforms. The fact that relevant policies are predominantly important and frequently changed is likely to undermine the authority and stability of laws and regulations. This is especially true for state enterprises which face great policy uncertainty in their reforms.

Throughout Chinese socialist history, property ownership has always been officially considered to be the most important factor in making, and subsequently changing, laws and policies concerning enterprises. Enterprises of different ownership are treated by different policies and governed by different laws (if any). Compared to other enterprises, state enterprises are more complex in that the rights and interests involved are more difficult to tackle. The factor of the state ownership not only signifies the immense difficulties caused by the

¹¹⁰ See Yang, supra note 96, pp.19-20.

presence of various government authorities, but also brings great confusion over the legal status of enterprises, their managers and workers. In the economic reforms, the success of the legal regulation of state enterprises has to depend on the proper treatment of many different interests and, certainly, of property rights.

CHAPTER THREE

LEGAL PERSONALITY OF STATE ENTERPRISES

This chapter examines the legal personality of Chinese state enterprises, and related issues. The discussion is divided into five parts. In the first part, after reviewing the background of the concept of "legal person" (faren), the discussion explains the reasons for the positive reception of the legal person concept in Chinese law. This is followed by an analysis of the legal requirements for Chinese legal persons with special reference to state enterprises. In the second part, the issue of property rights of state enterprises as legal persons is explored. In particular, the discussion seeks to illustrate the immense difficulties involved in defining property rights for state enterprises. The third part of this chapter discusses two constitutional issues, namely, the legal capacity of state enterprises and the ultra vires rule. The fourth part assesses the problems concerning the legal personality of state enterprises. Two major issues are discussed: "lifting the corporate veil", and "dual legal persons." The final part offers a conclusion with a summary of the functions and limits of the notion of legal personality in relation to state enterprises.

I. State Enterprise Reform and Corporate Personality

A. Legal personality: background

In Western company law, it is well-established that a limited company possesses legal personality, which distinguishes the company itself from its members. While common law jurisdictions have firmly adopted the notion of

corporate personality,¹ civil law countries tend to use the general and abstract concept of "legal person" (or "juristic person") to express the same meaning.² In addition, in spite of its Western capitalist origin, the concept of legal person has also been occasionally used in the laws of socialist countries, including the former Soviet Union.³

In China, although for a long time certain organisations had independent property and took part in social and economic activities in their own names, the notion of legal personality for organisations was not accepted in law until the adoption of the Civil Code (1929) of the Republic of China -- the first comprehensive civil legislation in China.⁴ After the founding of the PRC in 1949, all the laws previously adopted by the Republican authorities were abolished in mainland China, though some legal concepts survived. "Legal person", as one of those surviving concepts, first formally appeared in Temporary Measures Concerning the Conclusion of Contracts Between State Organs, State Enterprises, and Cooperatives (hereinafter "Measures").⁵ Article 5 of the Measures provided: "a contract

¹ For example, in English law, the principle of corporate personality was established merely a hundred years ago by the House of Lords in Salomon v. Salomon, (1897) A.C. 22.

² For example, the German Civil Code of 1900 used the notion of "juristic person".

³ The concept of legal person appeared in the Soviet Civil Code of 1923. Art.11 of the Fundamental Principles of Civil Legislation of the USSR and Union Republic (1961) stated: "organisations which possess separate property and non-property rights and bear duties in their own names, and be plaintiffs or defendants in court, arbitrazh, or arbitrations tribunal shall be juridical persons", "juridical persons shall be" "state enterprises and other state organisations" etc. See W.E. Butler, The Soviet Legal System -- Legislation and Documentation, Ocean Publications Inc, 1978, p.397.

⁴ For an early and general discussion, see Hu Changqing, Zhongguo Minfa Zonglun (General Discussion on Chinese Civil Law), Commercial Press (Beijing) 1933, p.102.

⁵ Adopted by the Financial and Economic Committee under the State Administration Council on Sept.27, 1950. For the text in Chinese, see Laws and Regulations of the PRC Central Government (1949-1950), p.696.

or deed must be concluded between legal persons represented by their responsible persons". Despite this provision, the meaning and implications of legal person remained ambiguous as no other legislation was available to explain this concept. Furthermore, the Provisional Regulations Concerning Private Enterprises⁶ promulgated soon after the Measures, though referring to the five types of companies which existed under the Company Law (1929) of the Republic of China, did not even mention the concept of corporate personality. In fact, apart from some academic discussions,⁷ there is no evidence to suggest the continuous use of this term by Chinese authorities in the coming years up to the early 1980s. Indeed, for most of this period, law was put aside in the PRC. And the concept of legal person was attacked as a bourgeois legal concept.

When China started its legal construction efforts in the late 1970s, the concept of legal person was soon revived in the minds of some Chinese lawyers aware of its importance, they began to advocate for the establishment of this concept.⁸

⁶ Promulgated on Dec.29, 1950. See the text in Chinese, ibid., pp.705-11.

⁷ For example, one book on civil law defined a legal person as a "social organisation which is established in accordance with legal procedure, which is able to independently participate in civil activities in its own name, and which can be plaintiff and defendant in court proceedings." The term of legal person was described as applicable to state enterprises, official organs, cooperatives, state-capitalist enterprises and social organisations. See Teaching and Research Section of the Central School of Political and Legal Cadres, Zhonghua Renmin Gongheguo Minfa Jiben Wenti (Fundamental Issues in the Civil Law of the PRC), Law Press 1958, p.68. However, it appears that even at that time, academic discussions had to distinguish carefully the socialist or capitalist nature of legal persons.

⁸ See Liu Qishan and Bai Youzhong, "Yingdang Queli Faren Zhidu" (The Legal Person System Should be Established), RMRB, Apr.23, 1981, p.5; Gao Shuyi, "Faren Zhidu Dui Woguo Shixian Sihua de Xianshi Yiyi" (Practical Importance of the Legal Person System on Realising Our Four Modernisations), FXYJ, No.4, 1980, pp.15-17; Yu Nengbin and Yang Zhenshan, "Minshi Zhuti -- Faren" (Civil Subjects -- Legal Persons), ZGFZB, Sept.4, 1981, p.3; also see Chen Kecong, "Zuowei Minshi Zhuti

In the early 1980s, the fact that the concept of legal person was an invention of Western law seemed to restrain some people from unconditionally welcoming the adoption of this concept in PRC law.⁹ But this did not turn out to be a critical obstacle as many advocates sought to reinforce their argument by expressly citing the precedent established in the Soviet civil law regarding the legal person institution.¹⁰ Indeed, earlier discussions among Chinese lawyers showed that they approached the legal person concept and its features in a way similar to their Soviet counterparts.¹¹

Despite the apparent enthusiasm of academics, support for the concept of legal person remained uncertain for several years. The Economic Contract Law ("ECL")¹² was the first law in which "legal person" was formally employed. But this law, to a great extent, used the term as a convenient tool for defining the contractual capacity of business organisations. Like the Measures of 1950, the ECL required that an economic contract be concluded only between legal persons.¹³ Except for the fact that enterprises were formally given the capability

Zhi Yi de Faren" (Legal Persons As a Kind of Civil Subjects), GMRB, Nov.17, 1981, p.3.

⁹ For a summary of different opinions concerning the adoption of the legal person concept, see Wang Baoshu and Cui Qingzhi, Jingji Faxue Yanjiu Zongshu (Summary of Research on Economic Law), Tianjin Education Press 1989, pp.72-4.

¹⁰ See, for example, Liu and Bai, supra note 8.

¹¹ For example, one commentator attempted to define a legal person as "a social organisation which possesses organisational structure and independent property, and which is able, in its own name, to participate in civil activities, to enjoy civil rights and bears civil liabilities, and to initiate and to defend legal proceedings in accordance with the law". See Yu and Yang, supra note 8. For the Soviet definition, see supra note 3. Also compare with supra note 7.

¹² Adopted at the Fourth Session of the Sixth National People's Congress on Dec.13, 1981.

¹³ Ibid. Art.1. However, the GPCL does not contain any such condition. It is therefore possible for an economic contract to be concluded either between individuals or between a legal person and an individual. See Art.85 of the GPCL.

to make contracts, there is little evidence to suggest that the legal person concept was used positively to authorise enterprises with significant independence and autonomy. Furthermore, due to the absence of comprehensive civil legislation, the definition and relevant requirements for a Chinese legal person were far from clear. In fact, the ECL¹⁴ still tended to use the old "socialist" concept of danwei (unit), rather than faren, to refer to various economic organisations. This reflected the fact that, at that time, the term of "legal person" was not yet familiar to many Chinese legislators and lawyers. Indeed, the unpopularity of the concept of legal person was confirmed by the fact that neither the Civil Procedure Law (For Trial Implementation)¹⁵ nor the 1982 Constitution employed this concept. Instead, the Constitution employed terms such as "social groups", "enterprises and non-business organisations" to describe various entities,¹⁶ even though many of these entities would have qualified as "legal persons".

B. State enterprise reform and legal person system

In the early 1980s, the significance of the notion of legal personality for the economic reforms, especially for state enterprise reform, had not been fully grasped. For example, some of the published discussions described the primary purpose of adopting the faren concept as being control of the activities of various organisations in the new situation of increasing economic exchanges.¹⁷ Nevertheless, while one of the advantages for acquiring the faren status by collective enterprises was described as "enabling them to defend their legal rights and interests from government

¹⁴ For example, Arts.4 and 5.

¹⁵ Adopted on Mar.8, 1982 and effective from Oct.1, 1982. This Law has been replaced by the Civil Procedure Law of 1991.

¹⁶ For example, Art.5.

¹⁷ Liu and Bai, supra note 8.

intervention",¹⁸ other discussions began to realise that the legal person system could be employed to help promote the autonomy of state enterprises.¹⁹

By the mid-1980s, it was agreed among most Chinese lawyers that the faren concept could be used for promoting China's socialist modernisation.²⁰ This was recognised in the legislation which began to take constructive moves towards establishing the faren system. On April 1, 1983, the State Council issued the Provisional Regulations Concerning State Industrial Enterprises (hereinafter "Enterprise Regulations")²¹ which provided:

[State industrial] enterprises are legal persons of which directors are the representatives. Enterprises shall exercise, in accordance with the law, the right to possess, use, and dispose of the state assets which the state authorises them to operate and manage, shall independently engage in production and operation, shall bear the responsibility to which the state prescribes, and shall independently initiate and defend court proceedings.²²

Therefore, the Enterprise Regulations not only recognised the legal person status of state enterprises, but also actually set out the privileges and consequences of enterprises as legal persons. In fact, until the promulgation of the GPCL, these consequences were widely regarded as basic requirements for a legal person in China.

The emergence of the faren concept in the early 1980s was partly due to the unprecedented drive to build a sound legal system in the PRC. However, more fundamentally, the promotion of the faren system reflected China's pressing need to speed up its economic reforms. In the beginning of the reforms, the Chinese leadership was concerned with finding suitable ways to

¹⁸ Ibid.

¹⁹ See Gao, supra note 8.

²⁰ See Wang and Cui, supra note 9, p.73.

²¹ For the text in Chinese, see Laws and Regulations of the PRC (1983), pp.383-99.

²² Art.8. Ibid.

invigorate state enterprises. In this respect, legal scholars, like other professionals, were required to make contributions. One of their immediate reactions was to adopt the faren concept. Thus, in one authoritative textbook on civil law published in 1983,²³ a faren was defined as "a form of social organisation that has self-operated property, and that can independently enjoy civil law rights and assume civil law duties".²⁴ After explaining the roles played by the legal person institution in capitalist societies, this book continued to illustrate several potential functions of the faren concept in the Chinese socialist legal system. One of these functions was that this concept could be used as "a legal device to increase the vitality of enterprises".²⁵ Although state enterprises were not particularly singled out for this purpose, the independence of legal persons was stressed and was implied to be applicable to all types of enterprises, including state enterprises.²⁶

Prior to the economic reforms, state enterprises were tightly controlled by the government. Every state enterprise, from its sources of materials to its production and distribution of products, from the appointment of its directors and managers to the arrangement of workers, had to follow strict state plans as well as government orders. Enterprises had little autonomy in making decisions regarding their own important matters. As a result, state enterprises were hardly concerned with making profits or suffering losses, because the government, as the owner, would bear all liabilities for their losses. It was obvious that state enterprises, being the "appendages" (fushuwu) of

²³ Tong Rou and others, Minfa Yuanli (Civil Law Basic Principles), Law Press 1983, p.51. For an English translation of the 2nd edn. (1987) of this book, see, W. C. Jones (ed.), Basic Principles of Civil Law in China, M.E.Sharpe, Inc. 1989, pp.61-78.

²⁴ See Basic Principles of Civil Law in China, ibid, p.65.

²⁵ Ibid.

²⁶ Ibid.

administrative authorities, had no freedom from government manipulation. This even constituted a significant contrast with the situation in the Soviet Union where state enterprises, as legal persons, could enjoy a great degree of autonomy and also were accountable for their own liabilities.²⁷

The post-Mao reforms have attempted to confer upon enterprises relative independence and to enhance the role of material incentives to enterprises. Thus, the idea of employing the fa ren concept to grant legal personality to state enterprises was seen as a positive step and soon accepted by the Chinese leadership. In 1984, the Central Committee of the Communist Party adopted the Decision Concerning Reforms of the Economic System (hereinafter "the Party's Decision") which has been regarded as the most important milestone in China's post-Mao urban economic reforms. The Party's Decision expressly listed one of the objectives of urban economic reforms as:

to make every enterprise become a truly relatively independent economic entity, and become a socialist commodity producer and manager which runs itself and assumes sole responsibility for its profits and losses, and has the capacity of reforming and developing itself, and becomes a legal person that enjoys its own rights and performs its own duties.²⁸

Less than two years after this official recognition, the GPCL was adopted to provide detailed treatment for the fa ren concept. Article 36 of the GPCL states that a legal person shall be an organization that has capacity for civil rights and capacity for civil conducts and independently enjoys civil rights and assumes civil obligations in accordance with the law. This definition of the fa ren concept, though found in

²⁷ In the Soviet Union, the policy towards state enterprises was partly based on the material incentives given to enterprises. For example, state enterprises could retain certain amount of their profits. But such material incentives were, except for a few years in the 1950s, not favoured by the Chinese authorities. For a discussion, see Chapter Five below.

²⁸ RMRB, Oct.21, 1984, p.4.

many academic discussions in the early 1980s, clearly reflected the perception held by the Chinese policy-makers of the faren concept. Without economic reforms, the faren concept would not have emerged so quickly in China. Although it was critical for China to accept the legal person concept as a prerequisite for the adoption of a comprehensive civil law, the acceptance of the legal person concept would have been neither possible nor meaningful if it had not been applied to state enterprises -- the dominant operators in the socialist economy of the PRC. In this context, the state policy to grant corporate personality to state enterprises played a decisive role in the reception of the legal person concept in Chinese civil law.

From the above description, it can be seen that the concept of legal personality was developed to a great extent in connection with state enterprises. Nevertheless, since this concept has appeared in the GPCL -- the basic document in the civil law area, it has had a broader application. In addition to state enterprises, other properly qualified enterprises are also eligible to become legal persons. These include collective enterprises,²⁹ foreign investment enterprises,³⁰ and even some private enterprises.³¹ Moreover, government offices, institutions, and social organisations may also obtain legal person status in Chinese law.³²

C. Requirements for a legal person

The GPCL states the legal requirements for a legal person

²⁹ Art.41, par.1, GPCL.

³⁰ Art.41, par.2, GPCL.

³¹ Art.9, PRC Provisional Regulations Concerning Private Enterprises, adopted by the State Council on Jun.3, 1988. Among the three types of private enterprises (sole trader, partnership, limited liability companies, only limited liability companies are eligible to acquire the legal person status.

³² Art.50, GPCL.

as:

- (i) establishment in accordance with the law;
- (ii) possession of the necessary property or funds;
- (iii) possession of its own name, organization and premises, and
- (iv) ability to independently bear civil liability.³³

These four requirements must be satisfied before an enterprise or organisation qualifies as a legal person.³⁴ Indeed, except for a few variations and certain stricter requirements, state enterprises are treated in the same manner as other types of enterprises, including collective enterprises and foreign investment enterprises.

1. Establishment in accordance with the law

Unlike many government agencies which are set up in accordance with administrative orders, enterprises must be established through registration "in accordance with the law". In this respect, many detailed legal rules are emerging.

In an attempt to unify the registration requirements of all enterprise legal persons, on June 3, 1988, the State Council adopted the Regulations on the Administration of Enterprise Legal Persons' Registration ("Registration Regulations").³⁵ Subsequently, on November 3, 1988, the State Administration Bureau for Industry and Commerce ("SABIC") promulgated the Implementing Rules for the Administration of

³³ Art.37.

³⁴ These requirements, however, were stated differently in the drafts prior to the GPCL. See Henry R. Zheng, "China's New Civil Law", in 34 American Journal of Comparative Law, 1986, pp.669-704, at 678.

³⁵ See the text in Bulletin of the State Council, June No.13, Jun.25, 1988, pp.420-26. Translated in 2 China Law and Practice, No.7, 1988, pp.33-41. The Registration Regulations replaced the Measures Concerning the Administration of Sino-Foreign Equity Joint Ventures (adopted Jul.26, 1980), Regulations Concerning the Administration of Registration of Industrial and Commercial Enterprises (adopted Aug.9, 1982), and the Interim Provisions Concerning the Administration of Registration of Companies (adopted by the State Council on Aug.14, 1985 and promulgated by the SABIC on Aug.25, 1985). See Art.39, Registration Regulations.

Enterprise Legal Person Registration Regulations
("Registration Rules").³⁶

According to the Registration Regulations and the Registration Rules, the Administrative Bureaux for Industry and Commerce ("ABIC") are authorized to charge enterprise registration.³⁷ Generally speaking, the ABIC exists at four levels: state, province (including autonomous region and centrally governed municipality), city, and county (or city district). The ABIC shall independently exercise their powers according to the principle of administering registration at different levels.³⁸ Thus, the ABIC at the national level, that is the SABIC, is responsible for the administration of registration of the following enterprises: national companies and large-sized enterprises which are established upon approval by the State Council or a scientific and technological society upon examination and approval by the department in charge of their particular trade; large conglomerates which are established upon approval by the State Council or upon examination and approval by a department authorised by the State Council; and enterprises engaged in import, labour export, or contracting for foreign engineering projects which are established by any of the departments under the State Council upon examination and approval by a department authorised by the State Council.³⁹ The ABIC at provincial level is responsible for administering the registration of companies and enterprises which are similar to these listed above but which are examined and approved under

³⁶ See the English translation in 3 China Law and Practice, No.3, 1989, pp.29-53.

³⁷ Art.4, Registration Regulations; Art.7, Registration Rules.

³⁸ Art.7, Registration Rules. But foreign investment enterprises are in principle registered with the SABIC and local ABIC authorised by the SABIC to register enterprises. See Art.5, Registration Regulations; Art.7, Registration Rules.

³⁹ Art.8, Registration Rules.

the power and jurisdiction of the provincial authority, and those enterprises or branches of which has been delegated by the SABIC to the provincial ABIC.⁴⁰ All other enterprises and companies shall be registered with the ABIC at the level of city or county (district).⁴¹

Basically, enterprise legal person registration involves three types of registration: business registration, alteration registration, and cancellation registration. In addition, some enterprises which need capital construction for a period of more than one year before establishment shall apply for preparation registration.⁴²

According to the SEL, before an enterprise can be formed, an application must be filed for approval with the government or a government department in charge in accordance with the law and the State Council regulations.⁴³ Thus, government approval is a prerequisite for the establishment of state enterprises. The contents of the application for such approval may range from the articles of association to the registered capital and even the nomination of the legal representatives of the proposed enterprises. Furthermore, the SEL lays down the conditions which must be satisfied for the establishment of an enterprise. These conditions include: products which are needed by the public; recurring supplies of production necessities such as energy, raw materials and transport facilities; its own name and premises for production and operation; its own organisational structure; definite scope of business; and "other conditions as required by legislation".⁴⁴

⁴⁰ Art.9, ibid.

⁴¹ Art.10, ibid.

⁴² Art.36, Registration Regulations; Art.60, Registration Rules.

⁴³ Art.16.

⁴⁴ Art.17.

2. Possession of its own name, organization, and premises

Every legal person must have its location of operation, its own name, and organization. In this respect, relevant laws and regulations have made many persuasive as well as prohibitive provisions. The term "premises" usually refers to the places suitable for the operation of enterprises. As for the names of enterprise legal persons, the Provisions Concerning the Administration of Registration of Enterprise Names have been promulgated by the SABIC.⁴⁵ According to these Provisions, the ABIC at all levels are the authorities in charge of the registration of enterprise names.⁴⁶ The name of an enterprise shall be preceded by the name of the administrative region in which the enterprise is located.⁴⁷ Moreover, in the absence of satisfactory reasons, the name of an enterprise should not be altered within a year of registration.⁴⁸ In addition, the name of an enterprise may be transferred with the whole or part of the enterprise.⁴⁹

The organizational requirement is met if enterprises which apply for registration have a number of workers and staff which is commensurate with the scale of production and business and business operation. No enterprise is permitted to be operated with less than eight full-time workers and staff.⁵⁰ In addition, all enterprises are required to possess

⁴⁵ Adopted by the State Council on May 6, 1991, and promulgated by the SABIC on Jul.22, 1991. For the text in Chinese, see XHYB, No.8, 1991, pp.85-7. These Provisions replaced the Interim Provisions Concerning the Administration of Registration of Names of Industrial and Commercial Enterprises, adopted by the State Council on May 23, 1985 and promulgated by the SABIC on Jun.15, 1985.

⁴⁶ Art.4.

⁴⁷ Art.7. There are exceptions for brand name enterprises, foreign investment enterprises, national companies, and some other enterprises covered by Art.13.

⁴⁸ Art.22, ibid.

⁴⁹ Art.23, ibid.

⁵⁰ See Art.15 (5), Registration Rules.

necessary business premises and facilities which are appropriate to the scope of business of such enterprises.⁵¹

3. Possession of necessary property and funds

Possession of necessary property or funds is a basic requirement for the operation of all legal persons. Enterprise legal persons must possess an amount of registered capital which conforms to the prescribed amount and which is appropriate to the scope of business of such enterprises. For example, the registered capital of production companies may not be less than 300,000 Yuan; the registered capital of commercial companies which are mainly engaged in wholesaling may not be less than 500,000 Yuan; the registered companies which are mainly engaged in retailing may not be less than 300,000 Yuan; the registered capital of consultancy companies may not be less than 100,000 Yuan; and the registered capital of other enterprises with legal person status may not be less than 30,000 Yuan. Where there are special state regulations concerning the amount of registered capital of an enterprise, such regulations shall be implemented.⁵²

4. Independent liability

The GPCL employs the concept of "independent liability" to describe the liability feature of all Chinese legal persons. However, within Chinese legal circles, there is considerable confusion over the meaning of this term. In particular, this term has been misunderstood by some as an equivalent to "limited liability".⁵³ In fact, "independent

⁵¹ See Art.15 (4), Registration Rules.

⁵² See Art.15 (7), ibid.

⁵³ An example can be found in the Regulations Concerning Foreign-Related Companies in the Special Economic Zones of the Guangdong Province (adopted on Sept.28, 1986, effective from Jan.1, 1987). While Art.3, par.2 of the Regulations assumes that "all foreign-related companies in the Special Economic Zones are limited liability companies", Art.149 seems to impose unlimited liability on partners of cooperative joint

liability" and "limited liability" differ in their meanings and substances.⁵⁴ Fundamentally, "independent liability" is reserved for legal persons, whereas "limited liability" is meant for shareholders of companies. For example, an unlimited company as legal person bears "independent liability", but its shareholders have to face unlimited liability.⁵⁵ Moreover, to hold that a company (legal person) bears limited liability is not only against the law,⁵⁶ but also detrimental to the interests of the shareholders.⁵⁷

In an attempt to clarify the meaning of "independent liability", the GPCL defines the scope of civil liability for several types of enterprise legal persons.⁵⁸ Therefore,

ventures. For a brief discussion, see Edward J. Epstein, "China and Hong Kong: Law, Ideology and the Future Interaction of the Legal Systems", in Raymons Wacks (ed.), The Future of the Law in Hong Kong, Oxford University Press 1989, pp.37-75, at 73. Here if Art.2 had been expressed as "all foreign-related companies...are companies assuming independent liability", then there would not have been such conceptual confusion.

⁵⁴ See Farrar's Company Law, Butterworths 1988, pp.67-8.

⁵⁵ Unlimited company does not yet exist in the PRC. Nevertheless, one standard textbook on company law, which recommends the recognition of this type of company in future PRC company legislation, states that "an unlimited liability company must also independently bear civil liability. What distinguishes unlimited companies is that unlimited liability shareholders themselves have to bear liability if the company cannot meet its liability in full with its own property." See Jiang Ping (ed.), Gongsifa Jiaocheng (Textbook on Company Law), Law Press 1987, p.25.

⁵⁶ See Art.48, GPCL. Also see Art.106 of the Implementing Regulations of the Law on Equity Joint Venture, which states that an equity joint venture shall be liable with "all its assets".

⁵⁷ See Boyle and Bird's Company Law, Jordans 1987, at 49 ("It is wrong to insert, as has been done, 'The Liability of the Company is Limited'. Such a variation, if passed by the Registrar, might produce results disastrous to the members."). Compare with the misleading expression that "a legal person has limited liability", in Zheng, China's Civil and Commercial Law, Butterworths 1988, p.310 .

⁵⁸ See Art.48, GPCL.

collective enterprises and foreign investment enterprises which qualify as legal persons are responsible to the extent of all the property which they own. But in the case of state enterprises, the extent of their civil liability is the property which the state has authorised them to manage and administer. As such, despite the fact that the state is the sole owner of state enterprises, the state is no longer responsible for the debts of the latter. This limitation of the state's liability contrasts greatly with the situation before the economic reforms when the state actually bore unlimited liability for the activities of state enterprises.

The concept of independent liability is also significant in that organisations which do not have legal personality are ineligible to bear independent liability. For example, as indicated earlier, not all cooperative joint ventures may qualify as Chinese legal persons. For those that are not legal persons, liability has to be determined in accordance with relevant contracts or general law governing partnerships.⁵⁹

The notion of independent liability has paved the way for the development of enterprise bankruptcy in Chinese law. For many years after 1949, the concept of bankruptcy was not applicable in the PRC. But just a few months after the adoption of the GPCL, the Enterprise Bankruptcy Law (EBL) was promulgated for future application to state enterprises.⁶⁰ Furthermore, the newly-adopted Civil Procedure Law (1991) contains a chapter (Chapter Nineteen) regarding the "Procedures for the Repayment of Debts Owed by Bankrupt Enterprise Legal Persons". Although this chapter only consists of eight articles⁶¹ which contain provisions similar to those

⁵⁹ The GPCL only makes stipulations concerning partnership between natural persons (see Arts.30-35). Therefore the partnership between enterprises may have to be decided by reference to the rules concerning "economic associations" (see Arts.52-3, GPCL).

⁶⁰ Adopted on Dec.2, 1986 and effective from Nov.1, 1988. For an analysis of this Law, see Chapter Eight below.

⁶¹ Arts.193-198.

stipulated by the EBL,⁶² it is applicable to all enterprises possessing legal personality other than state enterprises. The latter are still under the exclusive jurisdiction of the EBL.⁶³

5. Summary

An examination of the four legal requirements of a legal person in the context of Chinese law must be approached in broad terms. On the one hand, the requirements for a legal person as prescribed in the GPCL actually differ from those of academic discussion in the early 1980s and indeed even from earlier GPCL drafts. For example, before the adoption of the GPCL, one of the widely mentioned characteristics was a legal person's ability to conduct activities, sue, and be sued in its own name. The GPCL dropped this element. And the recent Chinese legal practice has shown that a non-legal person organisation may also use its own name on various occasions, including initiating and defending court proceedings.⁶⁴

A straightforward explanation of the requirements of legal personality in the PRC, however, does not necessarily reveal the distinguishing and fundamental characteristics of state enterprises as legal persons. This is mainly because these requirements are meant for all legal persons, rather than state enterprises as a special type of legal person. An accurate appreciation of the features of state enterprises as

⁶² For example, apart from the absence of "due to poor management", the test for enterprise bankruptcy as adopted in the Civil Procedure Law (Art.199) is similar to that provided in the EBL (Art.3). In addition, the order for the repayment of debts as provided in the Civil Procedure Law (Art.204) is the same as that provided in the EBL (Art.37).

⁶³ See Art.206, Civil Procedure Law (1991).

⁶⁴ For example, a workshop which does not have legal personality may rely on a Chengbao contract (discussed in Chapter Nine below) and bring legal action against the factory of which it is a workshop. For a discussion, see Gu Peidong, "Zhongguo Xianshi Jingji Chongtu Ji Qi Susong Jizhi de Wanshan" (Conflicts of Current Economic Interests and the Perfection of Litigation Mechanism in China), Zhongguo Shehui Kexue (Social Sciences in China), No.4, 1990, pp.211-23.

legal persons, therefore, requires detailed exploration of the functions and difficulties existing in the application of this notion to state enterprises. In particular, the difficulty in defining property rights and other profound implications of legal personality have to be further examined in order to show the nature and limits of state enterprises as legal persons in Chinese law.

II. Property Rights of State Enterprises as Legal Persons

A. Difficulties in defining property rights for state enterprises

As noted earlier, the amounts of the capital needed for the purpose of business registration are the same for all enterprises of the same industry. However, a notable distinction exists in the nature of property rights. A judge in the West can conclude without any hesitation that "the capital is the property of the corporation".⁶⁵ Moreover, it is well-known in the West that the property of a company differs from the property of its members and that the company is the sole legal owner of its property.⁶⁶

In the PRC, the issue of the property ownership is particularly sensitive and controversial.⁶⁷ In particular, the public ownership has always been regarded as the very basis of the socialist system. Before the post-Mao programme of economic reforms, the state as the owner, represented by government departments, directly managed every state

⁶⁵ See for example, per Lord Wrenbury, in Brandery v English Sewing Cotton Co. Ltd (1923) A.C. 744, p.767.

⁶⁶ See Henn and Alexander, Laws of Corporations, West Publishing Co., 3rd edn., 1983, p.146.

⁶⁷ For a general discussion, see Howard Chao and Yang Xiaoping, "The Reform of the Chinese System of Enterprise Ownership", in Stanford Journal of International Law, Vol.23, 1987, pp.365-97. Also see Wang Liming and Liu Zhaonian, "On the Property Rights System of the State Enterprises in China", in Law and Contemporary Problems, Summer 1989, pp.19-42.

enterprise. In the wake of economic reforms, such practice was condemned as ineffective and was to be abandoned. However, in establishing a legal person system, the issue of property ownership has not been properly treated.

At the beginning of the reforms, Chinese economists and lawyers presented many theories concerning the property rights of state enterprises.⁶⁸ But basically, those theories can be divided into two categories. One was concerned with the conferment upon state enterprises of the "property ownership rights" (caichan suoyouquan). Within this theoretical category, there existed two different approaches. The radical approach advocated that enterprises should possess complete ownership rights in respect of their property.⁶⁹ However, this approach seemed to be rather unpopular,⁷⁰ because there were worries that it might cause ideological confusion by undermining the public ownership. Another approach, which seemed to be less radical, advocated the authorization with state enterprises with "relative ownership rights" (xiangdui suoyouquan).⁷¹ This approach, though encouraging state enterprises to gain certain property rights in the property with which they operated, did emphasize the importance of keeping the state as the ultimate legal owner of state enterprises. Therefore, a two-tier system was to be applied.

However different these approaches were, the idea of

⁶⁸ For a summary, see Wang and Cui, supra note 9. Also see the comments on various theories in Jiang Ping and others, "Guojia Yu Guoying Qiye Zhijian de Caichan Guanxi Ying Shi Suoyouzhe Yu Zhanyouzhe de Guanxi" (The Relationship Between the State and State Enterprises Should Be the Relationship Between the Owner and the Occupiers), in FXYJ, No.4, 1980, pp.6-11.

⁶⁹ See Jiang and others, ibid, pp.74-5.

⁷⁰ Some articles advocating this approach did find their way into appearing in the Chinese press. See the discussion in Wang and Liu, supra note 67, pp.31-2.

⁷¹ See Liang Huixing, "Lun Qiye Faren Yu Qiye Faren Suoyouquan" (On Enterprise Legal Person and its Ownership Right), FXYJ, No.1, 1981, pp.26-31. Also see Wang and Liu, supra note 67.

granting state enterprises property ownership rights -- thereby undermining the concept of public ownership -- proved to be totally unacceptable to the Chinese authorities. Indeed, bearing in mind the overriding importance of the state ownership, many scholars attempted to look for compromise. On the one hand, state enterprises should be able to possess certain property rights. On the other hand, the state ownership had to be carefully preserved.

Such compromise was expressed in many different ideas. One theory⁷² pointed out that the state should remain the sole and ultimate owner of the property of state enterprises, but that state enterprises should be defined as the "^{possessor} zhanyouzhe" (zhanyouzhe) of these properties. According to this theory, the state ownership was the material basis by which the state ultimately controlled the means of production, while enterprises should be able to rely on "the right to ^{possess} zhanyouquan" (zhanyouquan), which derived from the ownership right, to pursue their self-management and their own independent interests.⁷³

Another theory, which has been more influential, centres on the management rights of enterprises. At first, this right was entitled "the right to manage and administer" (jingying guanli quan) -- a term borrowed from Soviet legislation.⁷⁴ Although use of this term in the late 1970s⁷⁵ and early 1980s

⁷² See Jiang and others, supra note 68.

⁷³ Ibid, p.8.

⁷⁴ This term was first suggested by a Soviet jurist, Wynijilatov, in the 1940s, and was then adopted into Soviet civil legislations in the 1960s. This term was later accepted by many eastern European countries, including Hungary and Checkslovakia. See Wang and Liu, supra note 67, p.28.

⁷⁵ One of the earliest use of this term was in "Some Provisions Concerning Expanding State Industrial Enterprises' Autonomous Right to Manage and Administer", promulgated by the State Council on Jul.13, 1979. See the text in Chinese, in Laws and Regulations of the PRC (1979), pp.249-52.

met with criticism,⁷⁶ it was nevertheless favoured by the government of the PRC for several reasons. First, this term was seen by many as being able to give enterprises sufficient legal rights to defend their independence and interests. Secondly, this term was more acceptable to economists. At least, this term appeared to be more comprehensible to economists than "the right to occupy", which was seen by many as a pure legal term. Thirdly, and most significantly, since this term did not affect the state ownership, it was acceptable to the Chinese authorities.

B. Management rights of state enterprises

Towards the mid-1980s, the rights of state enterprises to manage and administer state property were gradually recognised in Chinese legislation. The GPCL (1986) provides that state enterprises shall lawfully enjoy the right of management over the property that the state has authorised them to manage and administer, and their rights shall be protected by law.⁷⁷ The SEL (1988) also contains a similar provision:

the property of a state enterprise is owned by the whole people, the state authorises the enterprise to manage according to the principle of the separation of ownership from management.⁷⁸

The denial of property ownership rights to state enterprises has been justified by the wording of the GPCL regarding the legal requirements of a faren, which simply

⁷⁶ See Jiang and others, supra note 68, p.6. The main points of their criticism were: first, the term "administer" (guanli) was likely to be misunderstood as an administrative function; secondly, the right to manage and administer was not an independent right. Nor did it reflect the independent interests of enterprises; thirdly, "manage and administer" was an economic term, and not a legal term; finally, "manage and administer" was not only the right of enterprises, but the duty of enterprises.

⁷⁷ Art.82.

⁷⁸ Art.2.

employs "necessary" (biyao de), rather than "own" (suoyou de).⁷⁹ In other words, to be a Chinese legal person, a state enterprise does not have to **own** property. Instead, it is sufficient for it to **have the right to manage** certain property.

The denial of property ownership rights to state enterprises as legal persons contrasts with the legal treatment of the property rights of other enterprises. Let us take Sino-foreign joint ventures as an example. Direct foreign investment has been possible in China since 1979. At first, the Law on Sino-Foreign Equity Joint Ventures, apart from providing that a joint venture should take the form of a limited liability company,⁸⁰ did not directly touch on the issue of property rights. However, some Chinese scholars quickly pointed out that the provision regarding this particular form of joint ventures implied that the property of these enterprises was owned by enterprises as legal persons.⁸¹ They also argued that, since joint ventures which had received capital and other forms of property contribution by the state could enjoy ownership rights, and since collective enterprises as legal persons were eligible to possess property ownership rights, state enterprises as legal persons should have ownership rights in their property.⁸²

This view, however, was firmly rejected by the Chinese leadership. As a result, a demarcation has been made in the respect of property rights of different legal persons. On the one hand, the GPCL provides that foreign investment enterprises, together with collective enterprises, if qualified as legal persons, shall have rights of ownership in

⁷⁹ Art.37.

⁸⁰ Art.8.

⁸¹ See Liang Huixing, "Lun Qiye Faren Yu Qiye Faren Suoyouquan" (On Enterprise Legal Persons and the Ownership Rights of Legal Persons), in FXYJ, No.1, 1981, pp.26-31, at 30.

⁸² Ibid.

their property and funds.⁸³ On the other hand, despite their possession of legal personality, state enterprises cannot enjoy property ownership rights. Instead, they are only granted rights of management.

What, then, is the "right to manage" (jingyingquan)? It seems that this concept, though extensively discussed, is unclear both in theory and in practice. First, according to some scholars, the term of "management rights" specifically refers to granting state enterprises with sufficient rights to manage the property by resisting excessive state intervention. In particular, the late Professor Tong Rou, the chief founder of contemporary Chinese civil law, is quoted as suggesting that the term "management rights" has been deliberately used in Chinese legislation to replace that of "the right of management and administration".⁸⁴ It is further explained that "management rights" may avoid negative implications of the term "rights of management and administration" which involved both the administrative functions of state enterprises and the unequal relations between state enterprises and government departments. This argument seems to be theoretically sound because, unlike government departments which are "administering" state property, state enterprises are merely "managing" their property. However, in practice, the distinction between these two terms tends to blur. These two terms are often used together, they are found in close association in many laws, including the GPCL⁸⁵ and the SEL.⁸⁶ It follows that if these two terms were incompatible, it would be unthinkable for an enterprise to simply "manage" the

⁸³ Art.48 of the GPCL. However, according to Art.2 of the Sino-Foreign Cooperative Joint Venture Law, promulgated on April 13, 1988, not all cooperative joint ventures are eligible to become legal persons.

⁸⁴ See Shi Jichun, "Tong Rou Xianshen de Jingyingquan Sixiang" (The Right to Manage in the Mind of Professor Tong Rou), in FZRB, Mar.4, 1991, p.3.

⁸⁵ Art.82.

⁸⁶ Art.2, pars.2 & 3.

property with which the state has expressly authorised it to "manage and administer".

Secondly, in regard to the nature of "management rights", many scholars agree that such rights are "real rights" (wuquan), not "obligatory rights" (zhaiguan) or contractual obligations.⁸⁷ In other words, the rights of management are granted to state enterprises by law, not by special agreements between state enterprises and government authorities. By holding the rights of management, state enterprises are entitled to resist illegal and excessive interventions from any "outsiders", including government authorities.

Thirdly, the nature of the contents of management rights is controversial. The SEL provides that "enterprises have rights of possession, use, and disposal in accordance with the law" in regard to state property.⁸⁸ The rights to possess and to use the property are the same as those inherited in the ownership.⁸⁹ However, compared with ownership rights, management rights do not contain the right to "benefit" (shouyi) from the property. Moreover, the right to dispose of property, as defined in the right to management, is especially qualified by the wording "in accordance with the law".⁹⁰ This restriction reflects the official concern over the authorization of management rights to state enterprises. By denying the right to profits, the law allows great government

⁸⁷ See for example Tong Rou and Shi Jichun, "Woguo Quanmin Suoyou zhi 'Liangquan Fenli' de Caichanquan Jiegou" (The Property Right Structure Represented by the Separation of Ownership from Management in Our State Enterprises), in Zhongguo Shehui Kexue (Social Sciences in China), No.3, 1990, pp.159-74.

⁸⁸ Art.2.

⁸⁹ According to Art.71 of the GPCL, ownership means an owner's rights in accordance with law to possess, use, benefit from, and dispose of his own property.

⁹⁰ Art.71 of the GPCL (quoted in ibid.) requires that each ownership right be exercised "in accordance with law", in the case of "management rights", but the SEL only attaches this requirement to "the right to disposal of property". Thus, the requirement does convey special message in this context.

control over enterprises' right of the disposal of state property."⁹¹

Thus, according to the SEL, the absence of a right to benefit and the special qualification imposed on the right to dispose of property appear to be the crucial aspects where the management rights differ from ownership rights. Nevertheless, in practice, the contents of management rights are uncertain. Even Professor Tong admitted that in the absence of detailed legislative interpretation, management rights have been understood quite differently. In his view,

Management rights are the rights that state enterprises have, within the limits of state authorization, to possess, use, benefit, and to dispose of state property. State enterprises represent the state in exercising the rights of ownership in their civil activities with non-state enterprises. Management rights are not ownership rights, but they include all the rights which are essential for a commodity producer and manager."⁹²

Thus, "management rights" in the view of Tong are a broader concept than the "management rights" provided in the SEL. As will be shown in Chapter Four, the contents of "management rights" is variable, depending on relevant legal provisions and state policies.

III. Constitutional Issues of State Enterprise Legal Persons

A. Business capacity

As noted earlier, in 1984, the Party's Decision set one

⁹¹ For a discussion on this right, see Chapter Four.

⁹² See the extract of the speech made by Professor Tong Rou in the Seminar on China's Legal Reforms held in early 1989, as reported in FXYJ, No.2, 1989, p.28. In order to clarify the meaning of the term "management rights", Professor Tong further suggested that the state ownership rights in state enterprises should be defined as to include four aspects: deciding on the closing down, suspension of operation, amalgamation with another enterprise, and change to the manufacture of other products; assigning compulsory plans without affecting enterprises' economic interests; collection of enterprises' net profits; and approving the legal representatives of enterprises.

of the most important aims of economic reforms as to transform state enterprises into independent commodity producers. Prior to the post-Mao economic reforms, state enterprises did not have any important independent decision-making powers. But since the beginning of the programme of economic reforms, they have been given more powers so they can now engage in many activities which are not covered by state plans.⁹³ As a result, the issue of business capacity has become an urgent problem.

As indicated earlier, the business scope of state enterprises must be approved by relevant government or government departments and then registered with the ABIC at an appropriate level.⁹⁴ The notion of "business scope", or jingying fanwei, may embrace two different but connected contents: "business item" (jingying xiangmu) and "business pattern" (jingying fangshi). As for industrial enterprises, the registration of business scope usually means that of business items. But for commercial enterprises and some other enterprises such as those engaged in public catering, material supply and sale, storage, and local services, the registration of the business scope must, in addition to business items, identify "business patterns" which may take one of many forms such as wholesaling, retailing, supplying, importing, and exporting.⁹⁵

In many western jurisdictions, the business objectives may be exclusively decided by the promoters and shareholders of companies. But in the PRC, the ABICs, as the registration authority, are required by law to impose strict rules in examining and approving the registration of business scope of all enterprises. Among all basic principles which must be

⁹³ See the discussion in Chapter Four of the thesis.

⁹⁴ SEL, Art.16.

⁹⁵ See "Qiye Jingying Fanwei Heding Guifan" (Standards for Approving Enterprises' Business Scopes, promulgated by the Enterprise Registration Section, SABIC, in May 1987), in Jingji Shenpan Shouce (Handbook for Economic Adjudication), Vol.4, People's Court Press (Beijing), 1988, pp.81-251.

followed by the ABICs in approving enterprises registration, the ABICs must be prepared to examine the business scope in terms of capital, premise, equipments, staffing of the applicant enterprises, and enterprises' ability to bear economic liability.⁹⁶ In examining the application for business registration, the state business policy is a very important factor which the ABICs must consider. Both the Registration Regulations and the Registration Rules emphasize the role of the state policy as supplementary to formal laws and regulations of the state.⁹⁷ This implies that an enterprise whose business objectives are not considered to be consistent with state policy of the time may have its application for registration rejected. Furthermore, as a rule, an enterprise can only pursue one business as its main objective, though it may concurrently engage in other businesses as well.⁹⁸ But in any case, both the main objective and other businesses must be specified in clear term. Because the state intends to use the business scope to control the activities of enterprises, an enterprise whose objects are not clearly detailed is unlikely to be approved for registration. Nor is it easy for any party to persuade the ABIC or the court to adopt the liberal attitude in interpreting the provisions concerning the business scope in case of disputes.⁹⁹

In PRC law, the business scope has a wide range of legal implications. According to official explanations, the business scope approved by the ABIC represents an enterprise legal

⁹⁶ Ibid. p.82.

⁹⁷ Art.7, Registration Regulations; Art.15(8), Registration Rules.

⁹⁸ See supra note 102, p.82.

⁹⁹ Some Chinese scholars favour an approach which holds that, with certain qualifications, enterprises' business scope should be loosely interpreted to include all the "items which are necessary to carry out the objects as provided in the approved articles of association of enterprises and in the approved business scope." See Wang Baoshu and Cui Qingzhi, Qiyefa Lun (Enterprise Law), Workers' Press 1988, pp.117-18.

person's capacity for civil rights and civil conduct.¹⁰⁰ Moreover, it also reflects both the management right enjoyed by the enterprise and the duty borne by the enterprise not to operate outside its business scope.¹⁰¹ All enterprises are required by law to operate within their own scope of approved business.¹⁰² Failure to operate within the approved business scope may give rise to civil, administrative and even criminal liability for both enterprises and their directors.¹⁰³

B. Ultra vires rule

Operations which fall outside the approved business scope and main objectives of an enterprise are usually described as ultra vires activities. Traditionally, the strict application of the ultra vires doctrine would make all ultra vires activities invalid. Indeed, this doctrine has been effectively used in common law jurisdictions as a means for judicial supervision over government enterprises.¹⁰⁴ However, in recent years, this doctrine has been gradually abolished.¹⁰⁵ In China, the ultra vires doctrine has always been consistently preserved in order to force enterprises to act

¹⁰⁰ See "Standards for Approving Enterprises' Business Scopes", supra note 102, p.81.

¹⁰¹ Ibid.

¹⁰² Art.42, GPCL; Art.16, SEL.

¹⁰³ Art.49, GPCL.

¹⁰⁴ For a discussion on the effect of this doctrine in many jurisdictions, see W. Freidmann and J.F. Garner (ed.), Government Enterprise: A Comparative Study, Stevens & Sons (London) 1970.

¹⁰⁵ The substantial abolition of the ultra vires doctrine in English law took place in 1989. See Section 35 A of the 1989 Companies Act. For a general account of the Western development towards abolishing the ultra vires doctrine, see Fu Tingmei, "Gongsifa Zhong de Yuequan Yuanze Jiqi Gaige" (On the Ultra Vires Doctrine in Company Law and its Reform), FXYJ, No.4, 1991, pp.61-7.

within their approved business scope.¹⁰⁶ In this respect, the legal treatment of ultra vires contracts provides a good example for studying the functioning of the general ultra vires rule.

At first, the ECL (1981) did not expressly provide that the ultra vires economic contracts were necessarily void, though it may be argued that such an effect was actually implied.¹⁰⁷ On July 21, 1987, the Supreme People's Court issued an opinion concerning ultra vires contracts.¹⁰⁸ According to this opinion, economic contracts that are signed by an enterprise which have the effect of exceeding its business scope or infringing its business pattern should be regarded as void contracts. These include contracts which are concluded for dealing illegally in important means of production and rare and durable consumption goods; contracts signed by retailers for wholesale business; contracts signed by agents for their own retailing; and contracts for the sale of imported goods in unapproved areas.¹⁰⁹ Moreover, a contract which is entirely or partly ultra vires the business scope or business pattern of the enterprise is entirely or partly void.¹¹⁰ Accordingly, when a contract is deemed to be void due to its ultra vires nature, the enterprises involved shall return to each other any property that they have

¹⁰⁶ It must, however, be clarified that in China there is no generalised rule such as ultra vires, though in fact this rule does exist.

¹⁰⁷ Art.7 of the ECL reads: "the following contracts are void: a, contracts which are contrary to law, state policy and plan, ...".

¹⁰⁸ See "Zuigao Renmin Fayuan Zai Shenli Jingji Hetong Jiufen Anjian Zhong Juti Shiyong Jingji Hetongfa de Ruogan Wenti de Jieda" (The Supreme People's Court's Answers on Applying the Economic Contract Law When Hearing Cases Concerning Economic Contracts), in Jingji Hetong Faqui Shiyong Daquan (Practical Collection of Laws and Regulations Concerning Economic Contracts), China People's University Press (Beijing) 1989, pp.26-33.

¹⁰⁹ Ibid. p.28.

¹¹⁰ Ibid. p.28. Art.7, ECL.

acquired pursuant to the contract.¹¹¹ If one party is at fault, it shall compensate the other party for losses incurred as a result thereof.¹¹² If both parties are at fault, each party shall be commensurately liable.¹¹³

As mentioned above, in the PRC, the main objective for implementing the strict rule of ultra vires is to enable the state to control the business activities of legal persons. This control is by no means restricted to state enterprises. Indeed, all types of enterprises must operate within their business capacity approved by the ABIC. However, this control does have special implications for state enterprises because state enterprises do not own their property. They are simply "managing" the property which the state has authorised them to operate. In other words, state enterprises are bound to carry out their business objectives in the manner required by the state and relevant government authorities. It is impossible for a state enterprise to alter its business scope without obtaining prior approval of its superior government or government departments, not to mention the approval of relevant ABIC. In this respect, state enterprises do not enjoy the same freedom as other types of enterprises which can change their business activities provided that they carry out the the appropriate registration formalities required by law.¹¹⁴ Therefore, the ultra vires rule which is strictly applied in Chinese civil law may operate as an important means of control over the operation of state enterprises. In many cases, such rigid control is carried out at the cost of third parties and creditors who are, for example, prevented from enforcing ultra vires contracts to which state enterprises are a party.

¹¹¹ ECL, Art.16.

¹¹² Ibid.

¹¹³ Ibid.

¹¹⁴ See Art.17, Registration Regulations.

IV. Further Issues Relating to the Legal Personality of State Enterprises

A. Piercing the corporate veil

In the West, in the early days after the recognition of corporate personality, it was taken for granted that the legal personality of corporations should be preserved in determining their civil liability. Shareholders should not be made accountable, in excess to their promised contribution, for the debt liability of corporations which possessed legal personality. From the early Twentieth Century, however, courts in many jurisdictions have followed the American approach in lifting corporate veils which were abused. "Piercing the veil" is both possible and desirable when, for example, the corporate personality is used for the purpose of fraud or as a means to avoiding legal obligations, or when a legal person is controlled by another legal person in the same group, with the latter being potentially made liable for the former's debts.¹¹⁵ For some observers, "piercing the veil jurisprudence" has been regarded as having initiated a new enterprise theory of corporate personality.¹¹⁶

In China, piercing the veil jurisprudence is still largely unknown. In fact, both the EBL and the SEL have in principle denied any civil liability owed by the state (or government) to a state enterprise in the case of the former's faulty interference leading to the latter's bankruptcy. In theory, therefore, enterprise legal persons should only be responsible for their debts to the extent of the property

¹¹⁵ For a summary of European Continental law on this issue, see E.J. Cohn and C. Simmitis, "'Lifting the Veil' in the Company Laws of the European Continent", 12 The International and Comparative Law Quarterly, 1963, pp.189-225. For an account of relevant English law, see Farrar's Company Law, supra note 54, pp.73-81.

¹¹⁶ See Phillip I. Blumberg, "The Corporate Personality in American Law: A Summary Review", American Journal of Comparative Law, Supplementary Issue, 1990, pp.49-69.

which they own or "manage".

In practice, however, corporate personality was once disregarded. In August 1987, the Supreme People's Court issued an "Opinion" (pifu) on the debt liability of enterprises and companies promoted by administrative organs or enterprises.¹¹⁷ According to this Opinion, the debts of "enterprises" or "companies" established by administrative units should be first paid out of the property of the enterprises or companies, and the part which they could not afford to pay had to be made up for by those administrative units which approved and established the enterprises or companies, or which reported the establishment of the enterprises or companies. On the other hand, when a "branch enterprise" (fenzhi qiye) was established by an enterprise, if the branch enterprise was actually qualified as a legal person, its debt should be paid with its own independent assets; if the "branch enterprise" was not qualified as a legal person, the enterprise which established the branch enterprise should bear joint and several liability for the debts of the branch. But if the branch was a "company" (gongsi), **"regardless of whether or not it is a legal person"**, the enterprise which promoted the branch company had to be responsible for making up the debts which the branch company could not afford to pay in full.¹¹⁸ As such, the Opinion of the Supreme People's Court actually lifted corporate personality by asking certain connected entities (including administrative units and "enterprises") that established the enterprises and companies in question to be responsible for the debts of bankrupt "enterprises" and "companies".

The move towards lifting the corporate veil immediately caused great concern and genuine shock among Chinese

¹¹⁷ See the text in Chinese, Bulletin of the Supreme People's Court, No.4, 1987, p.21.

¹¹⁸ Ibid.

lawyers.¹¹⁹ They strongly argued that since legal persons should bear "independent liability", their corporate veil should not be lifted.¹²⁰ Thus, they resorted to the notion of independent liability in defending the corporate veil of legal persons.

In fact, one has to look at the general background underlying the move towards lifting the corporate veil. At the time when the Supreme People's Court issued its Opinion, the Chinese government had just begun to "consolidate" (zhengqun) enterprises, especially "companies" formed by administrative organs. This consolidation was a mass movement launched under the guidance of the Party and state policies. Indeed, the Supreme People's Court, in its Opinion, directly cited and referred to those policy documents jointly issued by the State Council and the Central Committee of the Chinese Communist Party. Accordingly, these policy documents to a great extent formed the very basis of the Opinion issued by the Supreme People's Court. The Opinion also set out the unequal treatment between ordinary "enterprises" (qiye) and special "companies" (gongsi),¹²¹ in the case of enterprises as their "promoters and sponsors" (kaiban ren). The fact that "enterprises" were indiscriminately held liable to pay the debts of the "companies" which they promoted in the first place, regardless of whether or not the companies were legal persons, can only be explained as a kind of penalty imposed on those enterprises keen to establish "companies" in order to make profits.

It is therefore clear that the decision to lift the corporate veil as instructed by the Opinion was taken less on the basis of legal reasoning than under the guidance of the

¹¹⁹ See, for example, Lin Rihua, "Guanyu Qiye Kaiban De Gongsi Daobi Hou Zhaiwu Qinchang Wenti de Jidian Sikao" (Some thoughts about the Payment of Debts Sustained by Bankrupt Companies Promoted by Enterprises), in FXPL, No.1, 1991, pp.84-88 and 69.

¹²⁰ Ibid.

¹²¹ The relationship between "enterprise" and "company" is very confusing in the Chinese context. For an analysis of the notion of "company", see Chapter One above.

particular state policy. To a certain extent, the challenge made by Chinese lawyers against the move is understandable.

In response to the concerns over the lifting of the corporate veil, on December 21, 1990, the State Council issued a Circular concerning the settlement of debts of abolished or merged companies in the campaign to consolidate companies.¹²² This Circular modified the position established by the Opinion of the Supreme People's Court. It required that companies which met the requirements of a legal person as provided by the GPCL and "which had dissociated themselves from the Party or government organisations as their promoters and sponsors", should as a rule pay their debts with the property which they were authorised by the state to manage or which they owned.¹²³ As such, the difficulties caused by the Supreme Court's Opinion was partially redressed. Although it seems that the Circular continued to lift the veil of companies which failed to disconnect themselves from government or Party authorities, it is clear that many other companies whose veil would have been lifted in accordance with the Opinion were eventually relieved by the new state policy as recognised in this Circular.

Although the campaign to consolidate companies ended in late 1991, it served as a clear illustration that corporate personality in China is not so absolute as to be upheld in all circumstances. The corporate veil can be lifted as a matter of special state policy. Furthermore, it has also been suggested by some Chinese lawyers that the idea of holding persons (both natural and legal persons) behind the veil liable for the debts of legal persons may be relevant both in domestic civil law¹²⁴ and in foreign investment enterprise law.¹²⁵ However,

¹²² For the text in Chinese, see Collection of Company Laws and Regulations, p.316.

¹²³ Ibid.

¹²⁴ It may be necessary to ask holding companies to be responsible for the debts of their subsidiaries. For a discussion of this problem, see Wang Baoshu, "Woguo Qiye Lianhe Zhong de Kangcaieng Xianxiang Jiqi Falü Duice" (On

opposition to lifting the corporate veil cannot be underestimated. This is not only because of the conceptual confusion over the notion of legal personality, but also because many Chinese lawyers still tend to overemphasize the "positive" function of legal personality in separating enterprises and their investors (shareholders or owners).¹²⁶ Consequently, it remains to be seen whether the jurisprudence which advocates piercing the corporate veil will be introduced in Chinese law on legal grounds similar to those already widely accepted in many western jurisdictions.

D. Enterprise conglomerates and dual legal persons

"Economic associations" (lianying qiye), also known as "enterprise conglomerates" (qiye jituan) have been emerging in China since the mid-1980s. Enterprises of different locations, different industries, and even different types of property ownership, may form economic associations or conglomerates. These entities are usually established for certain economic purposes, for example, to make use of productive or technological advantages. Recently, many conglomerates are formed under the auspices of government departments which seek

Newly Emerged Concern and Legal Disposition in China), in FXYJ, No.6, 1990, p.47.

¹²⁵ The corporate veil may be lifted as a matter of "international practice". Consequently, foreign investors may be held liable for the debts of foreign investment enterprises established in China. For a brief comment on this, see Yao Meizhen (ed.), Waishang Touzi Qiyefa Jiaocheng (Textbook on Foreign Investment Enterprise Law), Law Press 1990, p.67.

¹²⁶ One Chinese scholar has this comment on the Western concept of piercing the corporate veil: "considering the (low) standard of our legal system and the (inadequate) professional knowledge of judges, the adoption of this theory or practice (i.e., piercing the corporate veil) is likely to produce considerable discretion and to reduce the positive function of the legal person system". See Shi Jichun, "Woguo Jiben Jiti Jingji Lifa Chuyi" (My Humble Opinion on Basic Legislation Concerning Collective Economy in China), ZGFX, No.2, 1992, pp.33-41, at 39.

to enhance the collective economic strength of state enterprises. Some tightly united conglomerates possess unified property and funds, and participate in civil activities under the conglomerates' own independent names. They also have elected directors and are registered in accordance with the law. Such conglomerates are treated as legal persons in accordance with the provisions of the GPCL.¹²⁷ Other conglomerates, however, only exist nominally. They may have their own independent names and even common directors to coordinate their businesses, but they do not have joint funds and property, and therefore they cannot qualify to register as legal persons. Consequently, members or participants of such conglomerates shall bear liabilities respectively with the property that each owns or manages or otherwise in accordance with the agreement made between them.¹²⁸

The most difficult problem, however, is whether "dual legal persons" (liangji faren) can lawfully exist. That is to say, while a conglomerate is a "large" legal person, its members are also capable of being "small" legal persons operating under the "large" legal person. The concept of dual legal persons has been criticised by some commentators¹²⁹ as being contrary to the qualifications of a legal person in the GPCL, especially in the respect of the requirements of independent property and liability. It has been argued that, if a conglomerate is to possess legal personality, its participants must not be legal persons. In other words, these participants must give up their legal personality before joining the conglomerate legal person because it is impossible for both the conglomerate and its members to be legal persons.

Many reasons may be put forward for the denying recognition of the concept of dual legal persons. Since many

¹²⁷ Art.51.

¹²⁸ Arts. 52 and 53 of the GPCL.

¹²⁹ See for example Hu Yinkang, "Qiyue Jituan 'Liangji Faren' Zhi Wojian" (My Opinion on Conglomerates and "Dual Legal Persons"), FX, No.8, 1988, pp.40-1.

government departments are unwilling to surrender their powers to enterprises, they attempt to control a number of enterprises by setting up "conglomerates" which in fact are "administrative companies".¹³⁰ On the other hand, inadequate development of business organisational forms has prevented a reasonable understanding of the problem in question. In many western jurisdictions, a conglomerate may take the form of a company limited by shares (a holding company) with participants (also companies) becoming subsidiaries of the group. In this way both the conglomerate and its members are able to keep their own legal personality, and to be legal persons. However, China has so far failed to adopt a company law comparable to those found in many western jurisdictions. Nor is there any significant equity market. In the future, with the development of the limited companies, it might be possible to recognise dual legal persons. Moreover, the law may provide that a conglomerate may be made liable for the debts of its members if the conglomerate has abused its control over its member or indeed on other grounds. However, such a move has also to depend on the development of the theory and practice on "piercing the corporate veil" which, as analyzed above, is still uncertain in Chinese law.

V. Conclusion

In China, the concept of legal person, or faren, was conceived and adopted as an important element in the post-Mao programme of legal and economic reforms. The notion of legal personality, which is applicable to many enterprises and organisations, was perceived and employed as an essential means for transforming state enterprises into independent and self-governed entities.

To a great extent, the establishment of corporate personality must be viewed as a prelude to the overall legal regulation of state enterprises in China. It would hardly have

¹³⁰ These companies perform both business and administrative functions.

been possible to place state enterprises under the jurisdiction of law if their legal personality had not been officially recognised. Indeed, the legal personality of state enterprises had been widely emphasized in the economic reforms of the 1960s in the Soviet Union and Eastern Europe.¹³¹ In this respect, the post-Mao economic reforms, by recognising the legal person status of state enterprises, have served as a starting point in establishing a legal framework governing state enterprises.

The adoption of the legal person concept in Chinese law can facilitate the development of state enterprise reform. Theoretically speaking, by acquiring legal personality, state enterprises may act independently on many occasions and are also entitled to resist government intervention. In addition, since state enterprises may bear independent liability, the notion of legal personality may operate to make them solely liable for their own debts, thus shifting the burden of debt liability from the state to the enterprises themselves.

The adoption of the legal person concept, however, has failed to resolve many complicated problems in state enterprise reform. In particular, property rights of state enterprises have not been radically addressed. Unlike many other enterprises upon which property ownership rights have been conferred, state enterprises are prohibited by law from enjoying or even sharing ownership rights in the property with which they are operating. Instead, they are only granted "the right of management" -- a term borrowed from the legislation of the former Soviet Union and Eastern Europe.

The faren concept in Chinese law is strongly policy-

¹³¹ For a discussion on, inter alia, the legal personality of the state enterprises in these countries, see Gyula Eorsi and Attila Harmathy (ed.), Law and Economic Reform in Socialist Countries, Akademiai Kiado (Budapest) 1971. Also see Lajos Ficzer, The Socialist State Enterprise, Akademiai Kiado 1974. However, some scholars did not regard the legal personality as a constituent element of the notion of the state enterprise (see ibid. p.34). One of the reasons was that legal person as a civil law concept was not broad enough to contain various aspects of the complicated relations the state enterprise had to cope with (see ibid. p.48).

oriented. For example, the denial of the property ownership reflects the deep concern of the Chinese government over the authorization of legal personality for state enterprises. Moreover, despite the emphasis on the "independent liability" of legal persons, the corporate veil may be lifted as a matter of government policy.

The notion of faren has been employed by Chinese reformers as something of a magic notion that would be able to fundamentally change the existing enterprise system. By overemphasizing its assumed "positive functions", many Chinese scholars have idealised the notion of legal personality. As a result, when state enterprises fail to obtain a significant degree of independence and autonomy, they tend to blame that failure on the fact that state enterprises are not "real legal persons".¹³² The underlying message is that "real legal persons" would automatically possess many significant characteristics such as absolute independence and autonomy.

It is, however, over optimistic to expect a legal concept such as faren to play a decisive role in transforming the chaotic enterprise system. Due to the complexity of enterprise reform, the function of corporate personality is very limited. In essence, as described in the Party Decision cited earlier, the aim of reforms is to authorise "relative autonomy" to state enterprises. The question is then how "relative" such autonomy is. The answers to this question, as will be suggested throughout this study, will provide further evidence for assessing the functions and limits of the notion of legal personality in the legal regulation of state enterprises in post-Mao China.

¹³² See, for example, the comment made by Professor Jiang Ping. "Qiye Ying Chengwei Zhenzheng de Faren" (Enterprises Should Become Real Legal Persons", ZGJJTZGG, No.4, 1992, p.27.

CHAPTER FOUR

LEGAL GUARANTEE OF ENTERPRISE AUTONOMY

This Chapter discusses the legal guarantee of enterprise autonomy. To a great extent, enterprise autonomy concerns the relationship between the state and state enterprises. Such relations in the Chinese context are so complex that two separate chapters must be devoted to explore such relations. While this chapter provides general observations, the following chapter will specifically examine the legal aspects of the financial autonomy of state enterprises.

This discussion starts with a review of the history in the respect of the relations between state enterprises and their superior government authorities. The discussion especially explains the changing relationship in the course of the post-Mao economic reforms. After examining the legal framework concerning the rights and duties of state enterprises, the discussion attempts to delineate the authority and powers of various government departments which are associated with the operation of Chinese state enterprises. Having explored the subject theoretically, a practical assessment of enterprise autonomy is provided. Finally, a conclusion is offered.

I. Government Departments and Enterprise Management

A. General background

It has been indicated in earlier chapters that prior to 1979, Chinese state enterprises were placed under extensive control and supervision of government departments. Such a general statement, however, needs further explanation.

In March 1950, the Government Administration Council (GAC) promulgated a Resolution Concerning Unifying National Financial and Economic Work ("Resolution").¹ According to this Resolution, state-owned factories and enterprises were to be "managed" in one of three ways: first, those to be directly managed by ministries under the Central People's Government; secondly, those to be owned by the Central People's Government, but to be temporarily managed by local peoples' government or military organs as trustees; and thirdly, those to be managed by local government or military organs (as owners).²

Accordingly, the managerial responsibility for every state enterprise was to be ascertained. Generally speaking, the control of a state enterprise was exercised by either a Ministry at the central level or its corresponding agencies at a local (provincial, city or county) level. Some enterprises were, however, controlled by two or more government departments at the same level. In addition, a number of enterprises were identified as under the dual leadership of both central and local government authorities, though in this case one department, either central or local, had to be identified as the principal supervising authority.³

From 1950 and until the present day, the department or departments granted with the authority to manage a state enterprise are usually described as "government departments (authorities) in charge of the enterprise" (qiye zhuquan

¹ See the text in Chinese, in Laws and Regulations of the PRC Central Government (1949-1950), pp.239-44.

² Ibid, p.242.

³ It is very difficult to describe the jurisdiction of each government department at the same level, as the criteria for dividing the authorities of different departments are frequently changeable. For an attempt to define the responsibility for the eight Ministries concerned Machine Building, see A. Donnithorne, China's Economic System (1967), George Allen and Unwin Ltd., Second Impression 1981, p.150.

bumen).⁴ The main authority and responsibility of qiye zhuguan bumen are: defining the product direction and production scale of enterprises, handing down planned quotas, examining their fulfilment, ensuring that enterprises produce and control the materials which must be supplied according to the national plan, arranging the marketing of products, and helping enterprises solve production and operation problems.⁵

In addition to qiye zhuguan bumen, many other government departments and agencies such as banks, accounting offices and tax bureaux are also empowered to supervise and control the operation of state enterprises. Moreover, local government departments possess significant powers to control enterprises which are not under their direct supervision but which are located in their territories. Under the unified national state planning system, an enterprise which is put under exclusive supervision of a central Ministry may nevertheless have to obtain its production material from relevant local government departments.

In fact, since the 1950s, a state enterprise has been put under both "production branch vertical" (tiaotiao) control and

⁴ The term qiye zhuguan bumen is a very loose concept in Chinese law. It may have quite different meanings in different legal contexts. For example, laws and regulations concerning foreign investment enterprises may employ this term to refer to either government departments in charge of the Chinese partner (see Art.6 of the Implementing Regulations Concerning the Law on the Sino-Foreign Equity Joint Ventures), or government departments which are eligible to approve a project or production plan concerning the enterprise. This meaning is incompatible with the term used in this chapter, which simply has a stricter and narrower application.

Also, the term qiye zhuguan bumen should be translated properly as "government departments (authorities) in charge" and instead of "competent government departments". The latter term, by generally describing the relativity of certain government departments, can have a broader meaning to include relevant government authorities (such as the "ABIC") in addition to government departments in charge. Obviously, under no circumstances should the ABIC be a qiye zhuguan bumen.

⁵ For a general description in English, see Ma Hong (ed.), Modern China's Economy and Management, Foreign Languages Press (Beijing) 1990, pp.119-22.

"local horizontal" (kuaikuai) control.⁶ Usually, qiye zhuquan bumen, together with many other government departments that have the authority to supervise enterprises, are vividly called enterprises' "mothers-in-law" (popo) -- a term which, in the Chinese context, usually denotes excessive control.

This multiple control system, which continues today,⁷ has had (and still has) a number of negative effects. These effects were more obvious in the pre-reform era. For example, there was significant waste of labour and materials. It was common that the same product were made in different industries in the same region, or in the same industry of neighbouring regions. Under the strict planning system and tight government control, commodity exchange was not possible. As a result, neither economic efficiency nor the reasonable use of natural resources was realised. Furthermore, and most critically, enterprises were deprived of decision-making powers. All important management decisions were to be made by government departments in charge. Enterprises had to obey and implement the government's production and operation plans.

Under the rigid and multiple control system, materials needed for enterprise production were supplied by the government; products were purchased for sale by relevant government departments; profits were delivered in total to the national treasury; the additional fixed assets and working capital of enterprises were appropriated by government financial departments; enterprises' workers and staff members were assigned by the government, and their welfare and reward fund was drawn according to a fixed percentage of the wage payroll and was included in the cost. As a result, little material incentive was offered to enterprises, managers, and workers. Enterprises were totally dependent on government authorities.

In the 1950s and 1960s, the central government made

⁶ See Donnithorne, supra note 3, p.152.

⁷ For an economic analysis, see David Granik, Chinese State Enterprise, University of Chicago Press 1990, pp.20-7.

several attempts to reconstruct the relationships among enterprises, the central government, and local governments. However, except for occasional and insignificant move to grant enterprises certain autonomy by, for example, reducing the number of mandatory targets,⁸ those attempts were mainly concerned with the reallocation between central and local governments of the powers and control over enterprises. Little attention was paid to the fundamental issue of promoting enterprise autonomy. To a great extent, state enterprises remained as "appendages" of government departments.

B. Expansion of enterprise autonomy

The post-Mao economic reforms started with a new thinking about government -- enterprise relations. Like the Soviet Union and former East European countries which pioneered socialist economic reforms,⁹ the PRC leadership began in the late 1970s to confer upon state enterprises many decision-making powers which used to be exercised by government departments. Formal legal provisions have also been employed to guarantee enterprise autonomy.

As early as July 1979, the State Council issued "Some Provisions Concerning Expanding the Autonomous Powers Regarding Operation and Management of State Industrial Enterprises".¹⁰ The conferment of these "autonomous powers" (zizhuquan) marked the start of enterprise reforms. At that time, the autonomous powers were concerned with the partial

⁸ See China's Economic System, supra note 3, p.152.

⁹ For a discussion of the legal approaches to enterprise autonomy in these countries, see Gyula Eorsi and Attila Harmathy (ed.), Law and Economic Reform in Socialist Countries, Akademiai Kiado (Budapest) 1971. Also see Lajos Ficzer, The Socialist State Enterprise, Akademiai Kiado 1974, especially Chapter III, "The Legal Regulation of the Enterprise Autonomy".

¹⁰ See the text in Chinese, in Laws and Regulations of the PRC (1979), pp.249-52.

relaxation in selected aspects including production plan, selling of products, retaining of profits, use of funds, disposal of fixed assets, retention of foreign exchange income and arrangement of labour and personnel. While authorised with these powers, enterprises had to carry out many obligations. These included, sincerely implementing the state's guidelines, policies and laws, guaranteeing the fulfilment of state plans, preventing state property from being infringed, paying taxes and profits to the state in accordance with requirements, strictly complying with financial discipline, and guaranteeing the performance of economic contracts. Thus, the main objective for expanding enterprise autonomy was, while the state had retained de facto authority, to partially relieve enterprises from the extensive state control which had existed hitherto.

The expansion of enterprise autonomy was at first experimented with in selected enterprises located in provinces such as Sichuan. This practice was then extended to most state enterprises across the country in late 1980 and early 1981. The scope of autonomous powers was also gradually enlarged. On September 2, 1980, the State Council approved and transmitted "the Report Submitted by the State Economic Commission on Working Situation and Opinion Concerning the Future of Experimentation of Expanding Enterprise Autonomous Powers".¹¹ According to this Report, state enterprises were to enjoy expanded powers in, ad hoc, production plan and pricing. Therefore, enterprises were given the power to make their own production plans under the guidance of state plans and in light of market needs and their own production capacity. In carrying out state plans which were found unfeasible, enterprises were entitled to adjust the plans, provided that they should inform, or get the approval from, superior competent authorities. Moreover, enterprises might, under the guidance of state pricing policy, set floating prices for their products.

¹¹ See the text in Chinese, in Selected Enterprise Laws and Regulations, pp.128-39.

One momentous step towards expanding enterprise autonomy came on May 10, 1984 when the State Council issued "the Provisional Provisions on Further Expanding State Enterprise Autonomous Powers" (the "1984 Provisions", also widely known as the "Ten Articles").¹² Based on earlier developments, the 1984 Provisions consolidated ten autonomous powers, namely, planning production and management, sales of products, product pricing, selection of material supplied by the state, use of funds, disposal of assets, organisational arrangement, labour and personnel, wages and bonus, and associated production.

The expansion of enterprise autonomy can be seen as a considerable retreat in extensive government control over state enterprises. Enterprises' autonomous powers concerned not only economic interests but also other issues such as labour and personnel. The financial autonomy of state enterprises is to be examined in Chapter Five. Also important for enterprise autonomy is the contracting system which attempts to adjust and fix through contractual means the relations between enterprises and the state.¹³

The SEL (1988) contains two special chapters on enterprise autonomy. While Chapter Three is concerned with the "Rights and Obligations of Enterprises", Chapter Six is related to the "Relationship Between Enterprises and the Government". In fact, while the former specifies the rights and duties of enterprises, the latter is more concerned with the powers and obligations of relevant government authorities, including local governments, and especially government departments in charge of enterprises. In addition, some articles in other chapters of the SEL also affect, directly or indirectly, the enterprise -- government relationship.¹⁴

¹² See the text in Chinese, in Laws and Regulations of the PRC (1984), pp.479-82.

¹³ For an assessment of this system, see Chapter Nine of the thesis.

¹⁴ For example, Art.2 (forms of responsibility system), Art.16 (formations of enterprises), Art.18 (merger or division of enterprises), and Arts.59 and 61 (legal liability).

The combination of enterprise rights and duties in Chapter Three of the SEL reflects the concept of mutuality of rights and duties, which prevails in Chinese law, especially constitutional and family laws.¹⁵ Of the twenty-two articles contained in Chapter Three, thirteen are dedicated to provide for the rights of enterprises, while the remaining nine are concerned with their duties.

Before proceeding into a detailed examination of enterprises' powers and rights, it is helpful to assess the nature of the relationship between state enterprises and the state. As shown in Chapter Three of this thesis, the Chinese leadership has refused to grant property ownership rights to state enterprises which are only allowed to enjoy the rights of management towards the state property. Thus, the relationship between the state and state enterprises is essentially the relationship between the owner and the managers.

The autonomy of state enterprises can be analyzed from the following aspects: first, the powers and rights authorized to state enterprises are the main contents of, or the concretization of, the "management rights" as provided by law. Secondly, the contents of management rights are not always fixed. They may be expanded, but they may also be subject to restrictions. Thirdly, enterprise autonomy is "granted" to state enterprises by the state which is represented by the governments and their departments. Thus, in essence, these powers and rights are not necessarily inalienable to state enterprises.¹⁶

¹⁵ According to Art.33, Par.3 of the 1982 Constitution, every citizen enjoys the rights provided by the Constitution and the law, and at the same time must carry out the duties imposed by the Constitution and the law. For an illustration of the mutuality of rights and duties in Chinese family law, see Michael Palmer, "Some General Observation on Family Law in the People's Republic of China", in Michael Freeman (ed.), Annual Survey of Family Law, Vol.9, 1985, pp.41-68.

¹⁶ Some Chinese scholars questioned the expression of "expanding enterprises' autonomous powers". They preferred to use the term of "returning enterprises' autonomous powers".

II. Rights and Duties of Enterprises

A. Rights and powers

In terms of the rights of state enterprises, the 1984 Provisions singled out ten aspects. The SEL, with thirteen articles in this respect, not only reiterates the main contents as pronounced by the 1984 Provisions, but also adds two additional rights to enterprises, namely, the right of foreign trade, and the right to refuse random appropriation. The following observation is based on the SEL provisions. Since the stipulations in the SEL are very general and abstract, other relevant regulations, especially the 1984 Provisions, are frequently referred to.

a. planning for production: Under the guidance of state plans, enterprises are entitled to arrange by themselves for the production of products needed by the public or for the provision of services to the public.¹⁷ Moreover, enterprises are entitled to request the adjustment of mandatory plans which are not accompanied by planned supply of materials or by planned sale of products. In addition, enterprises may accept or reject production tasks arranged by any government department or unit outside the scope of mandatory plans.¹⁸

As a result of the post-Mao economic reforms, the state planning system has been relaxed. In the past, state plans

Their main argument was that the autonomous powers should belong to the state enterprises in the first place, though they were taken away in a highly centralised economy. See for example Wang Pengcheng, "Luelun Shehui Zhuyi Qiye Zizhuquan Jian Dui 'Kuoda Qiye Zizhuquan' Zhiyi" (A Brief Discussion on The Autonomous Powers of Socialist Enterprises and Questions Concerning 'Expanding Enterprises' Autonomous Powers'), in Wang Haibo and others (ed.), Jingji Tizhi Gaige de Lilun Yu Shijian Yantaohui Lunwen Ji (Collection of Articles Submitted to the Symposium on the Theory and Practice of the Economic Reforms), China Economy Press (Beijing) 1987, pp.198-205.

¹⁷ Art.22, SEL.

¹⁸ Art.23, SEL.

invariably took the form of mandatory plans. Since the mid-1980s, the Chinese authorities have tended to classify state plans into mandatory and guidance plans. Moreover, it is the government policy to gradually reduce the scope for mandatory plans and to enlarge step by step the scope for guidance plans. Enterprises have the autonomy and freedom to decide whether or not to follow guidance plans. Before making decisions, enterprises may take into account the market situation and many other factors. Nevertheless, mandatory plans remain important. Enterprises have the legal duty to carry out fully mandatory plans.¹⁹ In addition, enterprises must perform contracts concluded in accordance with the law.²⁰ In China, as in other socialist countries, economic contracts are treated as an important means to implement state plans. Although the ECL (1981) authorises certain contractual freedom to enterprises, it is explicitly provided that the conclusion and the implementation of economic contracts must not conflict with state (mandatory) plans.²¹

b. product sales: According to the SEL, enterprises are entitled to sell their products independently unless otherwise provided by the State Council. Enterprises which undertake tasks provided for in mandatory plans are entitled to sell independently both their products which are in excess of sales plans and products allotted to them under plans.²² The 1984 Provisions stipulates that, unless prohibited by the state, enterprises may sell such products as new products invented and produced by them, products which are not purchased by any state department, and overstocked products. In addition, the 1984 Provisions also provides for guidance as to the "self-sale" (zixiao) of several important products. For example, as for steel products, enterprises were allowed to sell two per

¹⁹ Art.35, SEL.

²⁰ Ibid.

²¹ See Arts.4, 7, 27 and 29, ECL.

²² Art.24, SEL.

cent of products which were produced under state plans, and all products produced over the state plans. In contrast, as to pig iron products, enterprises were not allowed to sell any products made within state plans, though they could sell such products made outside state plans. However, it is very difficult to tell accurately current situations by relying on regulations issued several years ago, because the quotes as provided in those regulations are frequently put under review and are subject to change.

c. selection of materials: Enterprises are entitled to select independently suppliers for the purchase of goods needed for their production.²³ Moreover, government departments in charge of ordering for goods should take full account of the requests from production enterprises, make balance in accordance with resources and transportation conditions, and then make reasonable arrangements. Enterprises may conclude contracts and settle accounts directly with materials' suppliers.²⁴

d. pricing: Except for products the prices for which the State Council has determined shall be controlled by government price control departments or relevant competent departments, enterprises are entitled to decide on the prices of their products and services.²⁵ In this respect, the State Council, on September 11, 1987, promulgated the PRC Regulations Concerning Price Administration ("Pricing Regulations"),²⁶ which replaced the earlier Provisional Regulations Regarding Price Administration of 1982.²⁷ The term "price" as used in the Pricing Regulations embraces both commodity prices and

²³ Art.25, SEL.

²⁴ Ibid.

²⁵ Art.26, SEL.

²⁶ See the text in Chinese, in Laws and Regulations of the PRC (1987), pp.501-11.

²⁷ Promulgated by the State Council on July 7, 1982. See the text in Chinese, in Bulletin of the State Council, No.13, 1982, pp.566-675.

business services fees.²⁸

Product prices may take one of three forms. The first form is prices set jointly and exclusively by the state pricing departments at or above county level and government departments in charge of enterprises.²⁹ Enterprises have no choice but to accept such prices. The second is state-guided prices. Enterprises may only determine prices within this category under the guidance set by the above mentioned government departments, by taking into consideration the standard price, range of fluctuation, difference of rate, profit level, and the maximum and minimum price limits so stipulated.³⁰ The third form is market-regulated prices. Enterprises as producers have full autonomy in determining this type of prices.³¹ In addition, enterprises may set the prices of quality products for which a price increase is permitted upon identification and affirmation by the department concerned and upon approval by the price control departments, provided that the increase is within the range permitted. They may also set, within the prescribed scope of authority, the bargain prices of worn-out or substandard goods.³² Finally, enterprises may decide, within the period prescribed by the state, the prices of new products for pilot sale.³³

e. foreign trade: Enterprises are entitled to negotiate and enter into contracts with foreign business entities in accordance with the stipulations of the State Council. Enterprises are also entitled to withdraw and use their foreign exchange reserve in accordance with stipulations of

²⁸ Art.5, Pricing Regulations, supra note 26.

²⁹ Ibid, Art.8, Par.1.

³⁰ Ibid, Art.8, Par.2; Art.17, Par.1.

³¹ Ibid, Art.8, Par.3; Art.17, Par.2.

³² Ibid, Art.17, Par.3.

³³ Ibid, Art.17, Par.4.

the State Council.³⁴ In the past, foreign trade was carried out exclusively by special state-owned trading companies. Since the mid-1980s, some ordinary state enterprises have been authorized to carry out direct foreign trade.³⁵

F. retained funds: Enterprises are entitled to dispose of and use their retained funds in accordance with the stipulations of the State Council.³⁶ This feature is further analyzed in Chapter Five below.

g. disposal of assets: Enterprises are entitled to lease or assign for value, in accordance with stipulations of the State Council, fixed assets given to them by the state to operate and manage. Benefits derived from such assets must be used for renewing equipment or improving technology.³⁷ According to the 1984 Provisions, enterprises enjoy the right to lease or assign for value fixed assets which are deemed to be unnecessary or idle. But as to equipments which, because of their high-grade, precision, and advancement, are under the administration of government departments in charge, any lease or assignment must be approved by these government departments.

h. wages and bonus: Enterprises are entitled to determine suitable forms of wages and methods for bonus distribution.³⁸ However, the PRC government has set forth unified standards for wages which differ in terms of region. There is also a national subsidy system which is changeable from time to time. It is on the basis of these standards that enterprises may choose their own suitable forms of wages.³⁹ Furthermore,

³⁴ Art.27, SEL.

³⁵ For a comprehensive discussion of China's foreign trade reforms, and state enterprises' rights of foreign trade, see Cheng Yuan, Changing Patterns in China's Foreign Trade Law and Institutions, Oceana Publications (New York) 1991.

³⁶ Art.28, SEL.

³⁷ Art.29, SEL.

³⁸ Art.30, SEL.

³⁹ Par.3, 1984 Provisions.

enterprise directors are entitled to upgrade wages for staff and workers who have made significant contribution, providing that the scale of such upgrading shall not exceed the rate set by the state.⁴⁰ In addition, enterprises have the autonomy to distribute the bonus fund drawn from their profits in accordance with relevant regulations.⁴¹

i. personnel management: Enterprises are entitled to employ and dismiss workers and staff in accordance with State Council regulations.⁴² Several attempts have been made to ensure the realisation of this right. First, since the adoption of the director responsibility system, enterprise managers have been authorised with powers to appoint and remove enterprise managerial personnel.⁴³ Secondly, more and more workers have been employed on a contractual basis. Enterprises have relative freedom to recruit, employ, and dismiss workers in accordance with relevant regulations.⁴⁴ Thirdly, on July 31, 1987, the State Council promulgated Regulations Concerning Labour Disputes Settlement, which provide for procedures for dealing with disputes arising from sanctions and the dismissal of workers.⁴⁵

j. installation of organisational structure: Enterprises are entitled to decide on the establishment of their

⁴⁰ Ibid.

⁴¹ Ibid.

⁴² Art.31, SEL.

⁴³ See Par.8, 1984 Provisions; Art.45, Pars.3, 4, & 6, SEL. For a discussion of this power and recent developments, see Chapter Six of the thesis.

⁴⁴ In July 1986, the State Council promulgated four sets of Provisional Regulations, concerning respectively Implementing Labour Contract System, Recruiting Workers, Dismissing Workers Violating Disciplines, Insurance for Unemployed Workers. For an discussion and translation of these regulations, see H.K. Jopsephs, "Labour Law in the Workers' State: the Chinese Experience", Journal of Chinese Law, Vol.2 1988, pp.201-63.

⁴⁵ For the translation and discussion, see ibid.

organisational structure and staffing.⁴⁶ The 1984 Provisions contain clearer stipulations: enterprises are entitled to, within the limits on the setup and the fixed number of staff members approved by government departments in charge, decide on the installation of their organisational structure and staff allocation, in accordance with the features of their production and the actual needs. Relevant government departments may propose to enterprises on the establishment of their organisational structure and staffing according to the needs of their professional works. But no government department is allowed to make compulsory provisions as to establishment and staffing within enterprises.⁴⁷

k. refusal of random appropriation: Enterprises are entitled to reject any demand from any government authority or unit for the contribution of manpower, materials or financial resources. Unless otherwise provided for in legislation, any request in any manner, for the provision of manpower, materials or financial resources from any government authority or work unit shall be regarded as random appropriation.⁴⁸ This aspect is further examined in later discussion.

l. economic association and issue of debentures: Enterprises are entitled to form associations with other enterprises or institutions in order to invest in other enterprises or institutions and to hold shares in other enterprises in accordance with the law and stipulations of the State Council.⁴⁹

In addition, enterprises are entitled to issue debentures in accordance with stipulations of the State Council.⁵⁰ In March 1987, the State Council promulgated Provisional Regulations Concerning the Administration of Enterprise

⁴⁶ Art.32, SEL.

⁴⁷ Par.7, 1984 Provisions. Also see Art.58, SEL.

⁴⁸ Art.33, SEL.

⁴⁹ Art.34, SEL.

⁵⁰ Ibid.

Debentures.⁵¹ Until 1992, the issue of debentures has been a privilege for state enterprises, since other enterprises including collective enterprises, with the exception of foreign investment enterprises, are prohibited from issuing debentures.⁵² The People's Bank of China is the government authority in charge of the issuing of enterprise debentures.⁵³ It has the power to approve the issuance of debentures, providing that the amount does not exceed the limit jointly controlled by the People's Bank of China, and state planning and financial departments.⁵⁴ If enterprises intend to issue debentures for the purpose of investment in fixed assets, such investment items must be investigated and approved by relevant government authorities.⁵⁵ Such requirements are set to control the random expansion of investment in fixed assets, and to ensure that priority for the issuance of debentures must be given to investment on key construction items covered by the state plan.⁵⁶

The above review suggests that state enterprises have been authorised by law with extensive rights and powers. It should also be noted that these are not all the powers and rights which a state enterprise may enjoy. For example, enterprises as legal persons are permitted by law to enjoy many intellectual property rights ranging from trade mark to patent and copyright. However, what mainly concerns the SEL and the present discussion is enterprise autonomy as opposed

⁵¹ See the text in Chinese, in Laws and Regulations of the PRC (1987), pp.330-33.

⁵² See "Guowuyuan Guanyu Jiaqiang Gupiao Zhaiquan Guanli de Tongzhi" (State Council, Circular Concerning Strengthening the Administration of Shares and Debentures, March 28, 1987). See the text in Chinese, in Laws and Regulations of the PRC (1987), pp.346-47.

⁵³ Art.4, Provisional Regulations, supra note 51.

⁵⁴ Ibid, Art.12.

⁵⁵ Ibid, Art.17.

⁵⁶ Ibid, Art.17; Par.6, Circular, supra note 52.

to government control. In this sense, compared with the pre-reform situation where enterprises were deprived of important decision-making powers, the legal provisions and combination of many enterprise powers are no doubt a very important step towards enterprise autonomy.

B. Duties and restrictions

The authorization of rights and power to state enterprises is not unconditional. Enterprise autonomy has been subject to many legal and non-legal restraints.

First, the authorization of powers is closely accompanied by a number of legal duties provided in the SEL. These duties relate to the implementation of compulsory plan,⁵⁷ the preservation of fixed assets and the improvement and renewal of equipment,⁵⁸ abidance of disciplines in regard to finance, audit, labour and wages, and price administration,⁵⁹ enterprises' social responsibility and consumer accountability,⁶⁰ economic efficiency,⁶¹ security and protection of state property,⁶² labour protection,⁶³ ideological and political education, legal, defence, scientific and cultural education, and technological training for workers and staff,⁶⁴ and research and development issues.⁶⁵ Although these SEL stipulations appear to be abstract and superficial, they are nevertheless extremely

⁵⁷ Art.35, SEL.

⁵⁸ Art.36, SEL.

⁵⁹ Art.27, SEL.

⁶⁰ Art.38, SEL.

⁶¹ Art.39, SEL.

⁶² Art.40, SEL.

⁶³ Art.41, SEL.

⁶⁴ Art.43, SEL.

⁶⁵ Art.43, SEL.

important in that they reflect the state's deep concern over the grant of enterprise autonomy. Indeed, as will be discussed below, in one way or another, the duties of enterprises and the rights and responsibilities of government departments are just two sides of the same coin. Many government departments have the legitimate power to supervise, and interfere with, enterprise operation. To this extent, the loose and abstract provisions regarding enterprises' duties are nothing less than a wide open door to government intervention.

Secondly, many rights delegated to enterprises by the SEL have been cautiously qualified by the wording of either "in accordance with the provisions made by the State Council"⁶⁶ or "unless otherwise provided by the State Council".⁶⁷ Such qualifications have restrained the effects of relevant legal provisions in the SEL, because the rights concerned may be "lawfully" deprived of or reduced by government authorities. Thus, many rights are put in an uncertain and unstable situation. Since the State Council and relevant Ministries may issue, and subsequently change, policy instructions, enterprise autonomy is likely to be severely affected from time to time. This characteristic is further revealed later in this chapter, as well as in many other chapters of the thesis.⁶⁸

Thirdly, it is always implied that the performance of enterprise' rights has to be conditioned by local regulations. Provisions of local authorities may help to clarify the ways for the realisation of certain rights, and possibly provide more flexibility than those stipulated by the State Council. As a result, differences always exist in terms of region. Regions such as Special Economic Zones and coastal provinces and municipalities tend to command clearer and more flexible treatments than inland areas. For example, as far as the sale of property of state enterprises is concerned, in Shenzhen,

⁶⁶ For example, Arts.27, 28, 29, 31 and 34, SEL.

⁶⁷ Arts.24 and 26, SEL.

⁶⁸ For example, Chapters Five and Nine.

according to the Tentative Provisions Concerning the Transfer of Interests in State Enterprises,⁶⁹ it is legally possible for the whole or part of the property (including shares) of state enterprises to be transferred to entities in a different industry or region, including foreign investment enterprises and private enterprises. This is a very liberal way for the disposal of state property.

To sum up, the SEL provisions regarding enterprise rights are neither clear nor radical. In fact, enterprise autonomy is conditional and dependent in nature. As will be shown later, the practical implementation of enterprise autonomy is rather difficult.

III. Role of the Government and its Departments

As explained earlier, governments and relevant departments at all levels, especially those in charge of enterprises, that is, give zhuguan bumen, formally played a dominant role in managing state enterprises. Since economic reforms are designed to grant relative autonomy to enterprises, governments and relevant departments are instructed to shift their authority from direct to indirect control over enterprise management.

A. "Government departments in charge", "relevant government departments" and "local governments"

In light of economic reforms, the SEL contains a special chapter -- Chapter Six -- for redefining the legal position of government authorities. In this Chapter, which consists of only four articles, the SEL employs three different concepts to refer to various authorities. The first is "governments or government departments in charge",⁷⁰ the second is "relevant

⁶⁹ Promulgated by Shenzhen Municipal Government on Apr.23, 1989. For an introduction, see China Law and Practice, Vol.3, No.6, July 10, 1989, pp.19-20.

⁷⁰ Art.55, SEL.

government departments",⁷¹ and the third "local governments at or above county level".⁷² Unfortunately, the SEL does not provide any definition or express guidance as to the meaning and coverage of these three concepts. As a result, considerable confusion is inevitable. Even if "governments or government departments in charge" may be interpreted as having a stricter meaning of referring to those governments or departments which may directly and administratively control enterprises by, for example, imposing compulsory plans, the coverage of "relevant government departments" is not certain. Furthermore, it is difficult to clarify the coverage of "local governments" as employed in the SEL. Since local governments may be the sole or joint owners of certain state enterprises, the relations among "local governments", "relevant government departments" and "governments or government departments", all used in the SEL, can be very controversial.

In order to understand the sophisticated regulatory framework through which various government authorities exercise control over enterprises, and the complicated relations between enterprises and relevant authorities, one has to ascertain the meaning and content of each of the above described concepts, and jurisdictions and the legal rights and responsibilities of the authorities concerned. In my view, the four articles (Articles 55-58) contained in Chapter Six of the SEL actually provide for not only exclusive but also to some extent inclusive relations among various government authorities. The meaning, jurisdictions, rights and duties of all relevant authorities are discussed and clarified as follows:

First, the term "government or government departments in charge" refers to those government authorities which, according to laws, regulations, or the constitutions of the enterprises, shall have the administrative power to exercise

⁷¹ Art.56, SEL.

⁷² Art.57, SEL.

direct control over enterprises.⁷³ By relying on vertical and administrative relationships, these governments or government departments in charge have the closest link with enterprises. In terms of their levels, these authorities may be central or local (including provincial, municipal, or even county), or both central and local.

The SEL stipulates that government or government departments in charge shall, in accordance with stipulations of the State Council, issue mandatory plans in a unified manner, ensure the planned supply of goods and materials required by enterprises to fulfil mandatory plans; examine and approve plans submitted by enterprises in respect of such matters as capital construction and important technological innovation; appoint, remove, reward and punish leading administrative cadres at the level of deputy factory director, and assess and train leading administrative cadres at the level of factory director.⁷⁴

Detailed analysis of some of the legally recognised powers possessed by this category of government authorities, such as the appointment of directors, is provided in other chapters of the thesis.⁷⁵ It is nevertheless sufficient to note that, having taken into hand so many important powers including control over planning and investment, governments and government departments in charge occupy an extremely important position in the overall supervision over the management of enterprises concerned. Except for possible quantitative improvements resulting from, for example, reduction of state mandatory plans for enterprises, the basic categories of powers exercisable by these authorities are

⁷³ See Art.5 of the Provisional Regulations Concerning State Industrial Enterprises (1983), which suggested that "units in charge of enterprises" (qiye zhuguan danwei) were those to whom enterprises were subordinate administratively. For the text in Chinese, see Laws and Regulations of the PRC (1983), pp.383-99 at 384.

⁷⁴ Art.55, SEL.

⁷⁵ See Chapters Five and Six.

similar to those which used to be practised by them before economic reforms.

Secondly, the responsibilities of "relevant government departments" are provided in Article 56 of the SEL. These responsibilities concern: formulating and adjusting industrial policies and guiding enterprises in their preparation of development plans; providing advice and information with respect to the business policies of enterprises; coordinating the relations between enterprises and other units; maintaining the normal production order in enterprises and protecting from violation the state property which enterprises operate and manage; and gradually perfecting public facilities related to enterprises.

The above provision is mainly concerned with services and responsibilities, rather than rights and control of government authorities. However, there are ambiguities and uncertainties in this provision. On the one hand, the term "relevant government departments" is not defined. Most Chinese writers⁷⁶ take the view that this term is the same as "governments or government departments in charge", as explained above. Considering that the provision in Article 56 regarding the responsibilities of "relevant government departments" comes immediately after the provision in Article 55 concerning the rights and powers of the "governments or government departments in charge", the view taken by many Chinese writers seems indisputable.

The problem, however, remains as to whether "relevant government departments" may be interpreted more broadly to cover those government departments which are not supposed to charge an enterprise but which are, in one way or another, associated with enterprise operation. In my view, a broad interpretation would serve more properly the aim and intention of the SEL. As described earlier, what the SEL attempts to

⁷⁶ See Wang Zongfei and others, Gongye Qiyefa Wenda (Questions and Answers Concerning the SEL), China Agricultural Machinery Press (Beijing) 1988, p.303. Also see Gao Kemin and others, Qiyе Zhi Hun (The Soul of Enterprises -- the SEL in the PRC), Sichuan People's Press 1988, pp.184-93.

achieve is to relieve enterprises from the extensive control of all, not just some, government authorities. It is in this direction that Article 56 employs the term "relevant government departments" (youguan bumen), rather than that of "government departments in charge" (zhuguan bumen). Furthermore, Article 56 states that "relevant government departments" shall, "according to their respective responsibilities", control and supervise enterprises in accordance with laws and regulations. Here the wording "according to their respective responsibilities" implies that many "relevant government departments" are caught by this provision. However, as indicated earlier, it is possible for some enterprises to have just one "government department in charge". A logical interpretation, therefore, would be that the term "relevant government departments" may possess a broader meaning than just referring to "governments or government departments in charge". If this interpretation is correct, "relevant government departments", excluding "government departments in charge", may embrace in particular state planning departments, and "industrial departments in charge" (hangye zhuguan bumen), such as Ministry of Light Industry, which are able to provide services and information to enterprises not under their direct supervision but of the same special trade.

Thirdly, "local governments at or above county level" ("local governments") shall be construed as merely referring to governments or their departments under whose jurisdiction enterprises are located, but which are not "governments in charge" of enterprises concerned. In other words, unlike governments in charge, "local governments" referred to by the SEL are actually not in a position to exercise administrative leadership over enterprises.⁷⁷ Nevertheless, because enterprises are seated in a given area, relevant "local governments" may play a significant role with regard to the operation of enterprises. The SEL provides that "local

⁷⁷ For a supporting view, see Wang, ibid, p.306.

governments" shall provide enterprises within their region with supplies subject to local planning control, coordinate the relations between enterprises and other local units, and endeavour properly to arrange for public welfare matters related to enterprises.⁷⁸ Here "public welfare matters" include, inter alia, health, education and communication. "Coordination" may cover, for example, the use by enterprises of local land. But generally speaking, like "relevant government departments", local governments shall mainly provide various services for enterprises, and shall not exercise direct control over enterprise management.

Fourthly, according to Article 58 of the SEL, no government departments or units may encroach on the autonomy which shall be lawfully enjoyed by enterprises in respect of their operation and management; nor may they demand contributions of manpower, materials or financial resources from enterprises or demand that enterprisers establish specific organisations or determine the size of enterprises' organisations. Such provision is obviously reiterating enterprises' rights and powers as a whole as provided in Chapter Three of the SEL and as discussed above. Enterprises' right to refuse random appropriation and their autonomy in organisation establishment are particularly singled out and given special emphasis.

B. Other government departments

Of the four articles concerning government authorities discussed above, Article 58 is the broadest in coverage. This is because this article is concerned with all, not just some, government departments or units. It is apparent that such a general declaration effects broader implications than the combination of "governments or government departments in charge", "local governments", and "relevant government departments" -- even in a loose interpretation as I attempted

⁷⁸ Art.57, SEL.

earlier. Government departments which are not explicitly referred to in Articles 55, 56 and 57, but which are potentially caught by Article 58, may cover, ad hoc, the ABIC, taxation, accounting, auditing, banking, and pricing departments. Some of the powers and responsibilities for these authorities are provided or mentioned in the SEL, but many more are only to be found in other laws and regulations. Some aspects are further discussed in other chapters of the thesis.⁷⁹ Here a brief discussion may serve to illustrate the important role played by these departments.

First, the ABIC at all levels may exercise supervision over enterprises. One important function for the ABIC in China is enterprise registration.⁸⁰ The ABIC is also authorised to supervise enterprises' activities. Thus, an enterprise will be ordered by the ABIC to cease business operation if it has not been approved by government departments in charge, or has engaged in production and operation in its own name before being approved by and registered with competent ABIC.⁸¹ Furthermore, an enterprise which provides the ABIC with false information in order to conceal their true position shall be warned or fined. In serious cases, the business licenses of such enterprises shall be revoked.⁸² Furthermore, the ABIC may ask people's court to enforce its decision which has not been appealed against within fifteen days after the receipt of the decision and which has not been implemented by the enterprise concerned.⁸³ Finally, according to the ECL, the ABIC has the authority to supervise the implementation of domestic economic

⁷⁹ See especially Chapters Three and Five.

⁸⁰ Art.16, SEL. See also the discussion in Chapter Three above.

⁸¹ Art.59, SEL. In such cases, the illegal incomes of enterprises will be confiscated.

⁸² Ibid.

⁸³ Ibid. Also see Art.66 of the Administrative Litigation Law (1990).

contracts.⁸⁴

Secondly, taxation authorities possess considerable powers in regulating enterprises' operation and incomes. The Chinese taxation policy and enterprises' financial autonomy are further elaborated in Chapter Four of the thesis. The authorities and powers of taxation departments are mainly represented in two aspects. On the one hand, there are rigid tax laws and regulations. In case of the violation of tax laws, the taxation authorities may decide whether or not to investigate an enterprise, and what kind of sanctions shall be imposed on an enterprise which has been found of misconduct or guilty. Obviously, in this respect, tax authorities hold considerable discretionary powers. On the other hand, provisions in some tax laws and regulations are not so rigid, and can be very flexible. Tax authorities may decide, independently or together with government departments in charge of enterprises, the rates, for example, of certain taxes. This is especially the case for the Adjustment Tax which is currently applicable to many state enterprises.

Thirdly, accounting supervision is meant to be a very important part of the state supervision over enterprises' operation. One of the central issues concerning the adoption of the Accounting Law,⁸⁵ which applies to, inter alia, state enterprises, is "to strengthen the supervision through accounting over the legality, reasonableness and effectiveness of [enterprises'] economic activities".⁸⁶ Accounting offices and accounting personnel of an enterprise shall exercise

⁸⁴ Art.51, ECL.

⁸⁵ Adopted on Jan.21, 1985, effective from May 1, 1985. See the text in Chinese, in Laws and Regulations of the PRC (1985), pp.67-73.

⁸⁶ See "Caizhengbu Fuzeren Jiu Kuaijifa Youguan Wenti Da Jizhe Wen" (Answers by the Responsible Person from the Ministry of Finance to Correspondents' Questions Concerning the Accounting Law), in Institute of Law, Chinese Academy of Social Science, Zhongguo Jingji Guanli Fagui Wenjian Huibian (Collection of Chinese Legislation Concerning Economic Administration), Jilin People's Press (Changchun) 1985, pp.994-96 at 995.

supervision over enterprises.⁸⁷ They are required to perform many duties. For example, they shall not accept any original documents that are unauthentic or illegitimate. Original documents which are inaccurately and incompletely recorded shall be returned for correction or supplementation.⁸⁸ An accounting office and accounting personnel shall not handle receipt or disbursements that violate the stipulations of the state uniform system of public finance administration and system of financial management.⁸⁹ However, in cases where an accounting office and accounting personnel believe that certain receipts and disbursements are in violation of the state uniform system of public administration and financial management, and where the unit's administrative head insists on their being handled, the said accounting offices and personnel may carry out the decision made by the administrative head, at the same time making a written report to the head of the superior administrative unit requesting action, and also to the auditing agency.⁹⁰ And more, accounting office and accounting personnel shall cooperate with taxation and auditing departments to supervise enterprises' activities.⁹¹ Since each state enterprise must have either an accounting office or at least some accounting personnel, the supervision through accounting is very important in relation to enterprises' management. Finally, it must be born in mind that the chief accountant within an enterprise may sit in the enterprise management committee to assist the director in making decisions regarding important matters.⁹²

⁸⁷ Art.16, Accounting Law, supra note 85.

⁸⁸ Art.17, ibid.

⁸⁹ Art.19, ibid.

⁹⁰ Ibid.

⁹¹ Art.20, ibid.

⁹² See Art.47, SEL; Art.11, Regulations Concerning the Work of Directors (1986).

Fourthly, auditing is also supposed to be a very important means by which the state supervises enterprise management. According to the Regulations Concerning Auditing,⁹³ large and medium state enterprises may establish internal auditing offices and auditing personnel to supervise the financial expenditure and economic efficiency of these enterprises and their subordinate units.⁹⁴ More importantly, state auditing organs are authorised with extensive powers to supervise enterprise' financial activities⁹⁵ and to impose sanctions as appropriate.⁹⁶

Fifthly, the banking system used to play a dominant role in supervising enterprises management. State banks not only performed their credit functions, but also were authorised to make direct debit and transfer of enterprise capital. Since economic reforms, state banks are urged to be commercialised.⁹⁷ Enterprises have greater freedom in obtaining loans and deciding on their own financial matters. Nevertheless, bank supervision over the floatation of cash, financial expenditures, and management and operations of enterprises still remains. Many large and medium-sized state enterprises continue to have the presence of officials from state banks, who are there to supervise enterprise operation.

Sixthly, pricing administration is significant. Government pricing authorities are entitled to set mandatory prices for certain materials and products. They may also set

⁹³ Adopted by the State Council on Oct.21, 1988 and effective from Jan.1, 1989. For the text in Chinese, see Bulletin of the State Council (1988), pp.840-46. Before this, the State Council, on Aug.29, 1985, once promulgated Provisional Regulations Concerning Auditing. See the text in Chinese, in Laws and Regulations of the PRC (1985), pp.253-48.

⁹⁴ Arts.27 and 28, ibid.

⁹⁵ Art.15, ibid.

⁹⁶ Art.16, ibid.

⁹⁷ For an introduction of China's banking system and reforms, see Henry Zheng, China's Civil and Commercial Law, Chapter III, "Banking Law", pp.87-127.

guidance prices for various goods. More importantly, they, together with masses organisations and consumer associations, may supervise enterprises in implementing state pricing policies.⁹⁸ In case of illegal pricing activities,⁹⁹ government pricing authorities may impose appropriate sanctions on enterprises.¹⁰⁰

C. Overall comment

The above discussions are just a bird's-eye view of the very complicated relations between enterprises and government authorities. It is neither possible nor necessary to list all government departments which enjoy some kind of authority towards enterprises, and their detailed functions. Government departments such as taxation, ABIC, banking, pricing and auditing are usually called "comprehensive functional departments" (zonghe zhineng bumen). These authorities, as a rule, are not "government departments in charge of specific enterprises" (qiye zhuguan bumen). Rather, they are put in a position to supervise all enterprises within their respective authority and jurisdiction.

Like government departments in charge of enterprises, functional departments used to perform a substantial administrative regulation over enterprises. But since the economic reforms, while government departments in charge, many other relevant government departments, and local governments are required to provide more services rather than to exercise administrative regulations, functional departments are guided to use economic levers and legal measures, rather than pure administrative methods, to regulate enterprises' activities.

As far as functional departments are concerned, reforms have produced mixed results. On the one hand, their role has

⁹⁸ See Chapter Five, Price Administration Regulations, supra note 26.

⁹⁹ For a definition, see Art.29, ibid.

¹⁰⁰ Art.30, ibid.

been severely cut back. On the other hand, despite the decline of their roles, these functional governments still, in one way or another, possess significant authority to influence enterprises. This aspect is further explored later.

With reference to the above comments regarding Article 58 of the SEL, it may become clear that the declaration in this article certainly takes into consideration the supervisory role of functional departments. In fact, this provision might be more broadly interpreted to include many organs and units other than "governments or government departments in charge", "relevant government departments", "local governments" and "functional government departments".

IV. Enterprise Autonomy: Practical Problems

The use of laws and regulations to adjust and govern the complicated relations between state enterprises and government departments, must be seen as a positive move towards enterprise autonomy. However, given the ambiguities in the SEL provisions and the absence of clear guidance as regards the respective authority and powers of government departments, it is doubtful whether state enterprises, being administratively subordinate to government authorities, can rely on mere legal provisions to defend their autonomy.

A. Survey results

In 1990, the All-China Trade Union Association conducted a survey to examine the actual implementation of the SEL. In the published results,¹⁰¹ enterprise rights were classified into eight large groups.¹⁰² Although such classification

¹⁰¹ See "Guanyu Qiyefa Luoshi Qingkuang de Diaocha Baogao" (A Survey Report on the Implementation of the SEL), JJGL, No.10, 1990, pp.24-7.

¹⁰² Ibid, p.24. In particular, it is unknown why the eleven kinds of enterprise rights as provided in the SEL were simply consolidated into eight.

seems to be chaotic, and to contradict SEL provisions, it is still possible to understand current practice by analyzing several interesting figures in the Survey result.

Of all surveyed enterprises, the percentages for the successful "basic implementation" (jiben luoshi) of enterprise rights were: seventy-six per cent of enterprises for both the right to use retained funds and the right to manage and run property; 70.3 per cent of enterprises for production autonomy; sixty-three per cent of enterprises for personnel arrangement and distribution of wages and bonus; sixty-one per cent of enterprises for management autonomy; and nine per cent of enterprises for the right to refuse random appropriation. None of the surveyed enterprises was found to be able to enjoy the right to share foreign exchange revenue, to participate in economic associations, and to invest in other enterprises.

According to another observation¹⁰³ which was also based on a special survey, enterprises are able to enjoy only two and half of the ten aspects of enterprise autonomy specified in the 1984 Provisions. The "two" meant the right to establish internal organisation and to sale products. And the "half" referred to the right to set prices under the "supervision" of government pricing administration departments.

The reasons for such a depressing situation concerning the implementation of enterprise autonomy were classified by the above observers into three categories. The first category was that government departments simply took away certain enterprise rights, for the purpose of macroeconomic control and economic rectification. This was a kind of straightforward measure resulting from the needs for implementing tighter economic policy. The rights which were deprived of in this way included the right to use retained funds, that to decide the distribution of the wages and bonus, and that to manage personnel and labour. The second set of reasons held that

¹⁰³ See Zhang Fujiang and others, "Qiyè Zìzhūquān Hài Shèng Duoshào?" (How Much Is Left for Enterprise Autonomy?), Qiyè Guānlǐ (Economic Management, Beijing), No.8, 1990, pp.42-3.

government authorities strengthened their control over enterprises in the name of "perfecting" (wanshan) enterprise autonomy policy. In other words, rather than genuinely promoting enterprise autonomy, government departments retained those rights which had been ordered by the central authorities to be devolved to enterprises. Such rights related to the rights to production plans, disposal of assets, selection of materials, and the determination of floating prices for certain products. The third category of reasons, according to that observation, was either because enterprises were unable to exercise their powers or because of certain irrational state regulations. For example, because many enterprises did not have sufficient retained funds, they could not exercise the right to invest in other enterprises.

B. Two examples

The above observations show that the general picture concerning the implementation of enterprise autonomy is far from satisfactory. In order to illustrate in more detail the difficulties facing enterprises, two of the enterprise rights as provided in the SEL deserve specific discussions. They are the right of horizontal association and the right to refuse random appropriation. The reasons for choosing them as examples are twofold. First, they are among those rights which have been implemented least satisfactorily. Secondly, while the former may be only concerned with governments or government departments in charge, and some relevant government departments, the latter involves miscellaneous government authorities and even many non-official units.

First, the right of "horizontal association" (hengxiang lianhe) first formally appeared in the 1984 Provisions and has been reiterated in the SEL.¹⁰⁴ According to relevant provisions, state enterprises may choose as partners, in supply, production and sale, those enterprises of different

¹⁰⁴ Art.34, Par.1, SEL.

industries, of different types of ownership, and of different regions. For example, a state enterprise may associate with collective enterprises, and even private enterprises, to form an enterprise conglomerate which may coordinate the activities of, and even impose unified plans for, member enterprises. Therefore, such associations are mainly aimed at breaking up vertical and regional restrictions by encouraging enterprises to freely select their partners. However, the 1984 Provisions contain a significant obstacle which remains effective until today. In participating economic associations, enterprises may not change their property ownership, may not change the established administrative subordinate relationship to government authorities, and may not change the prescribed channels for their financial accountability. These limitations are widely known as the "Three Non-Changes" (san bubian).

The Three Non-Changes rule has severely restricted the freedom of enterprises in horizontal economic associations. Government departments may abuse their powers and prevent an enterprise in an association from making important decisions concerning its operations. In some cases, horizontal association takes place in the form of a merger between two or more enterprises, or a takeover of an enterprise by another. If the enterprises concerned involve different government departments in charge (either regional or vertical), the approval by these government authorities is essentially necessary. If enterprises of different property ownership are involved, a horizontal association could be more difficult. Moreover, for those enterprises which have already participated in an enterprise conglomerate, government departments, especially those in charge and with financial responsibilities, tend to intervene in the operation and decision-making of their subordinate enterprises. As a result, a smooth cooperation between member enterprises of a conglomerate can be extremely difficult. On the other hand, many government departments in charge may force enterprises under their supervision to form enterprise conglomerates, even though enterprises involved are not willing to participate in

this kind of horizontal association. Thus, enterprises' right of economic association remains difficult to enforce.

Secondly, the right to refuse random "appropriation" (tanpai), as mentioned earlier, is formally provided in the SEL. This right was particularly aimed at protecting enterprises from many unfounded and illegal requests made by government departments which as a result of the expansion of enterprise autonomy felt a shortage of resources. First, the SEL expressly authorises enterprises with this right.¹⁰⁵ Secondly, all "organs and units" are required by the SEL not to appropriate.¹⁰⁶ And thirdly, according to Article 61 of the SEL, enterprises suffered from illegal appropriation are entitled to certain remedies.

In an attempt to enforce enterprises' right to refuse appropriation, on April 28, 1988, the State Council promulgated the Provisional Regulations Concerning Prohibiting Appropriations to Enterprises ("Appropriation Regulations").¹⁰⁷ The units which are forbidden to appropriate are listed broadly to include any state organs, people's groups, army units, enterprises, institutions, and any other social organisations.¹⁰⁸ According to the Appropriation Regulations, "appropriation" means "any action which requires an enterprise to provide financial resources, materials or manpower, and which is not supported by any law or regulations".¹⁰⁹

The Appropriation Regulations even identify certain actions as potential appropriations. For example, Article 4 lists thirteen types of fees, if not collected in accordance with law, as appropriations. These fees cover, inter alia,

¹⁰⁵ Art.33, SEL.

¹⁰⁶ Art.58, SEL.

¹⁰⁷ See the text in Chinese, in Bulletin of the State Council (1988), pp.387-90.

¹⁰⁸ Art.3, ibid.

¹⁰⁹ Art.2, ibid.

registration fees for children of enterprises' staff and workers, which are set by local education departments and schools themselves, social security administration fees, and health fees collected in various names. Even for those fees which can be collected in accordance with laws and regulations, any collection whose coverage, standard or way for collection has been changed constitutes appropriation.¹¹⁰ Moreover, no unit may compel enterprises to contribute, subsidize or donate financial resources and materials.¹¹¹ In addition, appropriation may take such forms as forcing enterprises to purchase negotiable securities,¹¹² or compelling enterprises to take insurances against items other than those required by laws and regulations for compulsory insurance.¹¹³

The Appropriation Regulations also lay down procedures for enterprises to resist appropriations. For example, if an enterprise is not sure about the nature of a fee item requested by another unit, it shall report it to the financial department of the unit's next highest people's government.¹¹⁴ The said financial department shall give an answer as to the payability of the fee within thirty days after receiving the report.¹¹⁵ If no answer is given within this period, it would be assumed that the financial department disagrees with the demand for the alleged fee.¹¹⁶ Only after the financial department has concluded that the fee can be paid may the enterprise pay.¹¹⁷ Moreover, if an enterprise does not agree

¹¹⁰ Art.5, ibid.

¹¹¹ Art.6, ibid.

¹¹² Art.7, ibid.

¹¹³ Art.8, ibid.

¹¹⁴ Art.13, ibid.

¹¹⁵ Art.14, Par.1, ibid.

¹¹⁶ Ibid.

¹¹⁷ Art.13, ibid.

with the decision of the said financial department, it can report to its next highest financial department.¹¹⁸

According to the Appropriation Regulations, state planning, financial, pricing, taxation, banking and other departments shall strengthen their supervision and check, and shall stop promptly any appropriation.¹¹⁹ However, it is the auditing department that shall, together with other relevant departments, carry out investigations into any alleged appropriation.¹²⁰ The auditing departments are vested with extensive powers to handle inappropriate appropriations. For example, it can order any unit to return the appropriated financial resources or materials, which can be done through bank's direct debit, or other means.¹²¹ Finally, responsible persons of the units which did the appropriation may be investigated by various government departments, including supervision and judicial departments, with possible administrative and criminal liability.¹²²

Despite these seemingly comprehensive legal provisions, the right to refuse random appropriation remain extremely difficult to enforce. The Appropriation Regulations are applicable to all enterprises registered with the ABIC,¹²³ but it is state enterprises that are suffering the most. This is mainly due to the fact that state enterprises are more vulnerable to government authorities. The above quoted Survey noticed that the units which appropriated money and materials from enterprises were principally those which could "condition" (zhiyue) in one way or another the enterprises in

¹¹⁸ Art.14, Par.2, ibid.

¹¹⁹ Art.17, ibid.

¹²⁰ Arts.15, 16 and 17, ibid.

¹²¹ Art.18, ibid.

¹²² Arts.19, 20 and 21, ibid.

¹²³ Art.25, ibid.

question.¹²⁴ It also revealed that only nine per cent of the surveyed enterprises were able to refuse illegal appropriation. Although 21.5 per cent of surveyed enterprises did not face random appropriation, 11.7 per cent of the enterprises suffered seriously.

Indeed, random appropriation has become one of the most serious threats to enterprise autonomy. Requests and orders for various fees, contributions, subsidies, and donations constitute extremely heavy burdens for enterprises. In practice, appropriations come from not only government departments, but also enterprises and social organisations. In particular, government departments in charge, relevant government departments, functional departments, and many other departments such as public security organs, may frequently make demands for financial resources, materials and manpower from enterprises. Many enterprises cannot afford to refuse such appropriations. This is mainly because these government bodies have various powers and authorities to control enterprises. Good relations between enterprises and government authorities are always one of the dominating factors which enterprises have to consider. For example, since many government departments hold too many discretionary powers with regard to enterprises' fortune, even if an enterprise can insist upon its right to refuse random appropriation from such government authorities, the enterprise is very likely to suffer heavily in the coming months and years. The Appropriation Regulations states that any retaliation against enterprises which resists random appropriation shall be forbidden and no unit shall treat enterprises discriminately by taking advantage of its administrative and professional authority.¹²⁵ But in practice, such provisions are not treated seriously. Enterprises have no option but to sacrifice their interests and autonomy, and give government authorities what they demand or order. As a result, the right to refuse

¹²⁴ Supra note 101, p.25.

¹²⁵ Art.11.

random appropriation is largely ineffective.

The above discussions have demonstrated that immense difficulties have made it impossible for enterprises to defend their legal rights to participate in economic associations and to refuse random appropriation. In fact, such difficulties are also present for the enforcement of many other enterprise rights. For example, the SEL states that enterprises are entitled to establish, within the quotas set by the state, their internal organisations¹²⁶ and no government organs and units shall ask enterprises to establish specific organisations or determine the size of enterprises' organisations.¹²⁷ But in practice, enterprises have encountered difficulties in enforcing this right. Many enterprises have been forced to establish many internal offices corresponding to government bureaucracy. These offices relate to armed personnel, public security, auditing, statistic, judicial, supervision, energy, standard measure and many others.¹²⁸ If an enterprise ignores order from government authorities and fails to establish relevant internal divisions, government officials will take every opportunity to retaliate and discredit enterprises. As a result, enterprises have to bear an expansion of unnecessary and unproductive personnel. Economic efficiency is sacrificed for the purpose of satisfying bureaucratic needs.

C. Limitation of administrative litigation

In order to fully understand the difficulties in enforcing enterprise autonomy, it is necessary to examine the availability of legal remedies when these rights are infringed. As mentioned earlier, Article 58 of the SEL

¹²⁶ Art.32, SEL.

¹²⁷ Art.58, SEL.

¹²⁸ See Peng Zhenmin and others, "Gaohuo Qiye de Zhengce Daodi Luoshi Le Duoshao?" (How Much of the Policy to Invigorate Enterprises Has Been Implemented?), in Jingji Gaige (Economic Reforms, Xi'an), No.1, 1991, pp.47-9 at 48.

generally declares that no government departments or units may encroach on the autonomy which is lawfully enjoyed by enterprises in respect of their operation and management. It also reiterates enterprises' right to refuse random appropriation and that to establish internal organisations. According to Article 61, where decisions of the government or of government departments in charge violate Article 58, the affected enterprise is entitled to apply for the cancellation of such decisions to the department that made the decision. If the application is rejected, the enterprise is entitled to appeal to the government department at the next highest level or the government supervision department. Departments which receive appeals shall, within thirty days, give a ruling and notify the enterprise of the ruling. Thus, Article 61 offers enterprises with merely administrative, rather than legal, means to defend their rights and autonomy.

The PRC Administrative Litigation Law ("ALL")¹²⁹ appears to provide a legal remedy for enterprises. According to Article 11 of the ALL, which defines the coverage of administrative litigations in the PRC, a legal person may take an administrative action if administrative organs have infringed on its "management autonomy" (jingying zizhuguan) provided by the law.¹³⁰ Although no official explanation is available for explaining this "management autonomy", it has been suggested by some observers that "management autonomy" shall cover those rights as provided by the SEL.¹³¹ This suggestion seems to reflect the intention of the NPC as the state legislature. Thus, it is theoretically possible that enterprises may rely on the SEL provisions to defend their

¹²⁹ Adopted on Apr.4, 1989, and effective as of Oct.1, 1990. For the text in Chinese, in Bulletin of the State Council (1989), pp.297-307. For an English translation, see China Law and Practice, No.5, June 1989, pp.37-55.

¹³⁰ Art.11, Par.3, ibid.

¹³¹ See Du Xiankong, "Woguo Xingbanbu de Xingzheng Susongfa Jianxi" (Brief Analysis on the Newly Promulgated Administrative Litigation Law), in ZFLT, No.2, 1990, pp.35-40 & p.78, at p.36.

autonomy against the government intervention.

Up to the time of writing, I am not aware of any such case brought by an enterprise directly relying on the SEL and the ALL.¹³² Any such potential case should be distinguished from litigation merely brought by enterprises against administrative sanctions taken by a specific government department. The latter, which includes cases regarding, for example, fines imposed by a government authority specialised in maritime environment protection, had been possible even before the ALL came into force, and depended on the relevant provisions in the Civil Procedural Law (For Trial Implementation)¹³³, as well as in various special laws.¹³⁴

In fact, several important issues have to be addressed before administrative litigation can come into full play:

First, the authority and powers of various government departments and the autonomy of enterprises must be clearly and reasonably defined in laws and regulations. Otherwise, it is very difficult, if not impossible, for enterprises to charge relevant government authorities for having infringed enterprises' management autonomy. Unfortunately, as shown earlier, it is very difficult to draw a clear line between the respective authority of many government departments.

The existing legal treatment contains two major problems. One is that the law is far from comprehensive. Abstract legal provisions can only be understood and implemented by referring to policy instructions promulgated by government authorities. However, these policy instructions are so changeable that

¹³² On my visit to China in early 1992, I was told by a number of government officials, law professors and judges that they never heard of the occurrence of such cases.

¹³³ Art.3, par.2. The 1982 Civil Procedural Law (For Trial Implementation) has been replaced by a new Civil Procedural Law (1991).

¹³⁴ In this case, see Art.41 of the Maritime Environment Protection Law of the PRC, adopted on Aug.23, 1982 and effective as from Mar.1, 1983. For the English-language text of this Law, see The Laws of the People's Republic of China, Foreign Language Press (Beijing) 1987, pp.296-304.

enterprise autonomy is severely affected from time to time. The other problem deriving from the present legal treatment is that the SEL attempts to outline not only the autonomy and duties of enterprises but also the rights and responsibilities of government authorities. Accordingly, there are many ambiguities as well as areas which are not covered by these provisions. This approach leaves great room to be fulfilled, and a great role to be played, by government authorities, therefore jeopardizing enterprise autonomy.

It must be admitted that it is not an easy task to use law to define properly the rights of state enterprises and the authority of government departments. For example, legislation adopted in the 1960s in the Soviet Union and Eastern Europe attempted to define the rights and responsibilities of state enterprises and government authorities by using either "positive" or "negative" methods, or indeed a combination of these two methods.¹³⁵ While the "positive" method referred to the way which expressly defined the rights and duties of enterprises, the "negative" or "exclusive" method was underlined by the principle that state enterprises were entitled to every right which did not encroach the enterprise autonomy. By comparing these two methods and by taking into account the difficulties in fully listing the rights for state enterprises, especially at a time of developing autonomy for enterprises, it was suggested that the second method, that was the exclusive method, was the better one.¹³⁶

In China, however, the method adopted by the SEL to define the rights for state enterprises is similar to the "positive" method. Therefore, a radical way to reform the

¹³⁵ For a discussion, see The Socialist State Enterprise, *supra* note 9, pp.56-8.

¹³⁶ Ibid. p.57. It was also pointed out that, if the exclusive method was adopted, for the purpose of protecting national economic interests, statutory provisions should be used to limit or exclude certain rights for the state enterprise. On the other hand, certain rights should be regarded as inalienable to the enterprise, and they had to be respected by government authorities (see pp.57-8).

present legal treatment concerning the rights of the state enterprise would be that the law should, instead of trying to make all the inclusive stipulations, provide both inclusive and exclusive stipulations. Ideally, the law should only state clearly and definitely the authority that respective government departments may lawfully possess in relation to enterprise management, leaving all other functions, rights and autonomy to enterprises.¹³⁷ In this way, the respective rights and duties of government departments and enterprises would be made clear.

Secondly, even if express decisions made by government departments can be challenged at court, so long as government departments retain authority over enterprises' activities, the informal influence, which may nevertheless severely affect enterprise autonomy, can hardly be prevented by threatening to bring legal actions.

Thirdly, even if an enterprise can resist the intervention of relevant and local government authorities, it is largely questionable whether it can sue those government departments in charge of itself, that is, qiye zhuguan bumen. Given that such government departments possess many decisive powers, including that to appoint and remove enterprises directors,¹³⁸ it is difficult for enterprises to insist its autonomy by merely relying on legal provisions.

Fourthly, it is at least worth considering the balance between the price of giving in to government departments and the potential huge cost which would result from a possible long process of litigation.

Last, but not least, even if an enterprise can succeed in

¹³⁷ The Soviet Law on the State Enterprise (Association) of June 30, 1987 adopted the principle that "everything that is not prohibited is permitted (to the state enterprise)". For an introduction of this law, see Vladimir Laptev, "Legal Foundations of the Functioning of Enterprises and Associations in New Economic Conditions", in USSR Academy of Sciences (Institute of the State and Law), Perestroika and Law, Nauka Publishers (Moscow) 1989, pp.65-79, at p.70.

¹³⁸ Arts.44 and 55, SEL.

administrative litigation against government authorities, such success may not be really worthwhile if the harmonious relationship between it and government departments is broken and if the enterprise is going to lose many future interests to government departments that possess great discretionary powers.¹³⁹

The combination of all the above factors, it seems, would be sufficient to prevent most, if not all, state enterprises from initiating administrative litigation in an attempt to reduce government interference in their management and autonomy.

V. Conclusion

In the post-Mao economic reforms, enterprise autonomy policy has gained formal legal recognition in the SEL and other laws and regulations. State enterprises have been granted a number of management rights. Government departments are instructed to apply indirect control and supervision, and to reduce direct intervention in enterprise operation.

These legal attempts reflect positive moves towards promoting enterprise autonomy. Enterprises have obtained a certain degree of autonomy which did not exist before the reforms. However, the present legal treatment contains critical shortcomings. The SEL provisions do not provide clear and radical provisions with regard to the rights and powers of enterprises. Enterprise autonomy are readily and necessarily subject to qualifications and restrictions imposed by central and local governments and their departments which used to directly manage state enterprises. Moreover, a number of declarative and abstract stipulations in the SEL regarding enterprise duties, together with other relevant laws and regulations, provide government authorities with easy access to interfere with enterprise management. As a result, the extent of government authority over enterprises is far from

¹³⁹ For a further discussion of this aspect, see Chapter Nine of the thesis.

clear, leaving uncertainty to enterprise autonomy.

In practice, the implementation of enterprise autonomy is rather disappointing. Many rights and powers provided by the SEL for state enterprises are not only dependent on changeable state policies but also liable to excessive government control. The employment of legal mechanism to adjust and govern the legal relations between state enterprises and the state, therefore, falls short of the effectiveness and success that one might expect.

The PRC authorities are aware of the ineffective implementation of enterprise autonomy. In an attempt to revitalize large and medium-sized state enterprises, in May 1991, the State Council issued a circular¹⁴⁰ calling for new measures to be implemented. Thus, state enterprises will be allocated with less compulsory plans and may enjoy more autonomy in selling their products; some state enterprises may be authorised to carry out direct foreign trade. In particular, in order to reduce the burden on enterprises, government departments and other units have been told to stop illegal appropriation from enterprises. The new policy has been followed by many regional efforts to grant further autonomy to state enterprises.¹⁴¹

Since early 1992, state enterprises have been granted full autonomy in deciding on the wages for their workers and staff. In order to break "iron salaries", "iron bowls" (for workers and staff), and "iron chairs" (for cadres), government departments have been ordered to abolish all their previous rulings regarding the income distribution of enterprises under their jurisdiction. Enterprises will be allowed to, within the

¹⁴⁰ For the text in Chinese, see RMRE, May 30, 1991. Reprinted in XHYB, No.5, 1991, pp.45-6.

¹⁴¹ For a report, see "Pilot Reforms to Revitalize State Enterprises", in BBC SWB, Oct.31, 1991, FE/1217, B2/4. According to this report, for example, the Shanghai Municipal Government has granted a number of state enterprises with independent decision-making powers over many internal issues such as production planning, marketing, accounting, capital construction, technological upgrading, tax payment, employment, distribution and export.

wage scale set by government authorities for urban workers, autonomously set their own salaries based on the success of their operation as well as the performance of individual workers.¹⁴²

No doubt, these new measures will promote enterprise autonomy. But one has to bear in mind that the essential relationship between the state and government authorities on the one side and state enterprises on the other is the relationship between the owner and the manager of state property. The current reforms are merely concerned with the partial relaxation, not abolition, of extensive government control. It is the duty of government departments to keep a close eye on the management of state enterprises. Accordingly, under the present enterprise system, a difference can only be drawn between more or less government interference, rather than between existence or nonexistence of such interference.

Since the late 1980s, several more radical methods have been experimented with in pilot enterprises and selected areas. For example, the shareholding system attempts to limit the role and capacity of the state and government departments by defining them as shareholders in limited companies.¹⁴³ Concurrent with this reform is the attempt to replace existing government departments in charge with a new government department entitled "state assets administration bureau" (guoyou zichan guanliju). The National State Assets Administration Bureau was formed in September 1988 and put under the supervision of the Ministry of Finance and the State Planning Commission. It is expected that this reform will relieve enterprises from the multiple controls currently exercised by many government departments. Enterprises will be held only responsible to the state assets administration bureau which shall make important policy decisions concerning enterprise administration. Other government departments will

¹⁴² For a report, see "China Gives Enterprises Autonomy Over Wages", China Daily, Apr.14, 1992, p.1.

¹⁴³ For an assessment and future prospect of this system, see Chapter Ten.

be either abolished or kept away from supervising enterprises.

Since 1988, in Shenzhen Special Economic Zone of Guangdong Province, a "board of directors" (dongshihui) has been established in some state enterprises. According to relevant regulations.¹⁴⁴ The board consists of managers, workers, entrepreneurs and economists selected from the society, as well as representatives from the government.¹⁴⁵ It shall represent the state as the owner of enterprise assets, and act as the highest decision-making body within an enterprise.¹⁴⁶ The board is entitled to make important decisions including development strategy, appointment and removal of directors, approval of management targets, and other important financial and social issues.¹⁴⁷

All these reforms have so far been carried out on a limited scale. Their effect is not yet clear. In terms of the relationship between enterprises and government departments, the abolition of various government departments in charge must be seen as a remarkable step forward. However, it remains to be seen how far these reforms would reduce government control as a whole, bearing in mind the new control by the state asset administration bureaux. The policy of "relative" autonomy, which has been declared as the fundamental aim of state enterprise reform, faces an uncertain future. So does the existing legal framework which is aimed at protecting enterprise autonomy.

¹⁴⁴ See Provisional Provisions Concerning the Work of the Boards of Directors in State Enterprises Owned by Shenzhen City. For the text in Chinese, see Shenzhen Jingji Tegu Nianjian (Yearbook of the Shenzhen Special Economic Zone) 1989, Guangdong People's Press 1990, pp.500-2. Obviously, the experimentation is principally concerned with those state enterprises which are wholly owned by the Shenzhen Special Economic Zone, though other state enterprises (i.e. those owned by provincial and central governments) can "make reference" to these regulations. (see Art.28)

¹⁴⁵ Ibid, Art.5.

¹⁴⁶ Ibid, Art.2.

¹⁴⁷ Ibid, Art.10.

CHAPTER FIVE

LEGAL ASPECTS OF FINANCIAL AUTONOMY

This chapter discusses the legal aspects of the financial autonomy of state enterprises.¹ Part One reviews the Chinese socialist policies of profit distribution from the 1930s until 1983. Part Two covers the primary reforms from 1983 to 1987, and concentrates on the system of taxation for enterprises. Part Three discusses the changes which the current contracting system has brought about and briefly looks at the possible future trends in this area. Part Four examines the legal nature of profits retained by state enterprises. The final part offers some concluding remarks.

I. Policies and Problems Before 1983

A. Taxation and profit distribution policies before 1978

The origin of the Chinese Communist taxation can be traced to a time as early as 1931 when the Provisional Taxation Rules were promulgated for the Chinese Soviet Republic.² These Rules, on the one hand, abolished the

¹ Tax laws and regulations are only discussed to the extent that they are directly related to the tax reform concerning state enterprises. For a general and detailed discussion on China's taxation system, see A.J. Easson and Li Jinyan, "The Evolution of the Tax System in the People's Republic of China", in R.H. Folsom and J.H. Minan (ed.), Law in the People's Republic of China, Martinns Nijhoff Publishers (Dordrecht) 1989, pp.830-51. Also see T.A. Gelatt and Ta-kuang Chang, Corporate and Individual Taxation in the People's Republic of China, Longman (Hong Kong), 2nd edn. 1987.

² See "Zhonghua Suweiai Gongheguo Zanxing Shuize" (Provisional Rules of the Chinese Soviet Republic), promulgated on Nov.28, 1931 and effective from Dec.1, 1931.

taxation system imposed by the Nationalist Government, and on the other hand, introduced new taxes on certain activities.³ Although these Provisional Taxation Rules were fairly simple, they did to some extent reflect Chinese Communist attitudes towards taxation. Taxation was basically regarded as a necessary, but not a preferred, revenue source. It was necessary because money was needed to support the civil war against the Nationalists. In addition, because of the co-existence of state-owned factories and cooperative and private industries in Communist-controlled areas, taxation had to be imposed, especially on private enterprises, in order to prevent them from "exploiting".

From the 1930s and until the end of the Socialist Reform of Bourgeois Industries and Commerce in 1956, different taxation policies were adopted for different types of enterprise. The Resolution for the Adoption of the Provisional Taxation Rules of 1931 expressly set forth class principles of taxation. It was decreed that the burden of taxation should be imposed upon "exploiting" classes and the duty to pay taxes be lifted for the exploited classes and poorest masses.⁴ Accordingly, the Commercial and Industrial Taxes on consumption and productive cooperatives might be remitted if these cooperatives were approved by a county government and the approval subsequently reported to a superior provincial government.⁵

After the foundation of the PRC in 1949, the central government adopted various taxation policies to cope with enterprises of differing types of property ownership. In 1950,

For the text in Chinese, see Zhonghua Suweiai Falü Wenjian Xuanbian (Selected Legal Documents of the Chinese Soviet Republic), Jiangxi People's Press 1984, pp.291-95.

³ There were only three types of taxes, namely, commercial taxes, industrial taxes and agricultural taxes.

⁴ Arts.6 and 19, ibid.

⁵ Arts.6 and 19, ibid.

the Government Administration Council (GAC) promulgated the Primary Rules for the Implementation of National Taxation Administration (hereinafter the "Primary Rules"),⁶ as an important step towards unifying national taxation policy. These Primary Rules provided for fourteen kinds of taxes.⁷ In principle, "public enterprises must pay taxes according to regulations" and "cooperatives must also pay taxes to the state".⁸ However, detailed regulations showed that discriminatory policies applied. For example, public enterprises, including state enterprises, were not to pay income tax, and cooperatives might get remittance or reduction to their income tax. Another example of inconsistent tax treatment occurred in the respect of Services Tax. From 1953, as to the same activity of wholesale, private enterprises were required to pay Services Taxes, but public enterprises were entitled to a remittance.

The varying policies described above reflected the Chinese government's dislike of taxation of public ownership enterprises. It is generally agreed that "profit" (lirun) differs from "taxation" (shuishou) on the ground that lirun is the income directly derived from investment while shuishou is levied by the state as the social administrator of enterprises and other entities. Accordingly, the state cannot directly benefit from private enterprises in the form of lirun, although it can impose shuishou on private enterprises. But as regards state enterprises, the situation can be confusing. The state is not only the social administrator but also the sole

⁶ For the text in Chinese, see Laws and Regulations of the PRC Central Government (1949-1950), pp.283-85.

⁷ These were: product tax, industrial and commercial tax (including services tax, income tax, street pedlar licence tax, temporary commercial tax), salt tax, custom tax, wage income tax, deposit interest income tax, stamp tax, inheritance tax, transaction tax, animal slaughter tax, house property tax, land property tax, tax on special consumption activities, tax on license plate for the use of vehicles and boat. Some of them, including inheritance tax, were however never put into practice.

⁸ Art.8.

investor in these enterprises. This dual status of the state has caused considerable policy confusion over the use of either taxation or direct profits payments in the case of state enterprises.

The treatment of "Income Tax" (suode shui) provides a good example for the present discussion. Income Tax is usually treated as the most important source of financial revenue in any jurisdiction. The Provisional Taxation Rules of 1931, being too simple, did not make clear the status of Income Tax. Nevertheless, before the establishment of the PRC in 1949, in some Communist-controlled areas, Income Tax on public enterprises was levied. For example, in 1948, the Administration of the Northeast China promulgated the Provisional Regulations on Commercial and Industrial Income Taxes in the Liberated Areas of Northeast China ("Provisional Regulations"). These Provisional Regulations, while authorising relief for certain public ownership industries, did require all enterprises, whatever their ownership form, to pay Income Taxes.⁹ However, the Provisional Regulations Concerning Industrial and Commercial Taxation of the PRC¹⁰ of 1950 cancelled income taxation on public enterprises. Instead, direct profit payments became the main source of state revenue from these enterprises.¹¹

⁹ For a detailed description of the rates of taxes, see Zhu Jianhua, Dongbei Jiefangqu Caizheng Jingji Shigao (Financial and Economic History of the Liberated Areas in Northeast China), Heilongjiang People's Press 1987, pp.454-56. It is noteworthy that the rates for income taxes did vary for different types of enterprises.

¹⁰ See the text in Chinese, in Laws and Regulations of the PRC Central Government (1949-50), pp.298-316.

¹¹ Ibid. Art.5 provided: "Of the industrial and commercial taxes payable by public enterprises, the service taxes out of their turnover should be paid locally; and the income taxes should be replaced by the direct profit payments which shall be made in accordance with special measures." On Mar.3, 1950, the Government Administration Council adopted the Provisional Measures Concerning the Collection From Public Enterprises of the Industrial and Commercial Taxes. For the text, see ibid. pp.320-21.

From 1950 and until 1983, potential income taxpayers were mainly collective and private enterprises as well as individual businesses. In fact, private and individual businesses almost disappeared after 1956 and did not reemerge until the early 1980s. The tax reforms, launched respectively in 1952, 1958, 1963 and 1972, were clearly moving towards the simplification of the tax regime, especially in the number of the categories of taxes. As a result, after 1973, no more than ten kinds of industrial and commercial taxes survived.¹² While conducting these reforms, the government made clear its intention that taxation should be mainly aimed at discriminating between different types of enterprise. For example, according to the Tentative Measures Concerning Adjusting the Burden of Industrial and Commercial Income Taxes and Improving Taxation Administration of 1963,¹³ in order to restrict individual economy and to strengthen collective economy, individual businesses were required to pay more Income Taxes than collectives. On the other hand, especially after the Socialist Reform of Bourgeois Industries and Commerce, which was concluded in 1956, the confusion about the taxability of state enterprises deepened. An extreme example was the experimentation in 1959 when some enterprises in seven industrial cities including Nanjing and Wuhan were chosen to test a new system under which no tax, whatsoever, was to be collected from state enterprises. Instead, state enterprises were required to hand in profits, in accordance with state plans, to the government. The amount to be handed over was the combined annual total of their previously paid taxes and profits. That experimentation caused so many problems¹⁴ that

¹² The PRC Regulations on Industrial and Commercial Tax (Draft) were adopted by the State Council in March 1972 and effect from January 1973. See the text in Chinese, in Selected Enterprise Laws and Regulations, pp.730-32.

¹³ Promulgated by the State Council on Apr.13, 1963. For the text in Chinese, see ibid., pp.726-30.

¹⁴ Those problems included random price reduction by enterprises previously paying high rate taxes, inequality in the distribution of profits between industries and commerce,

it was soon cancelled. However, such failure did little to change the government's dislike of taxation on state enterprises. The confusion over the taxability of state enterprises remained for a long time until the late 1970s.

The idea that state enterprises should pay profits rather than taxes to the government was not found only in the thinking of the PRC government. For example, the Soviet Union had practised such a system and therefore provided a model for the Chinese government. However, the practical implementation of this idea differed considerably in these two countries.¹⁵ In the Soviet Union, profits made by an enterprise were, in principle, kept by the enterprise and its supervising government department for the purpose of expanding future production. Thus, the amount of profits which went into the state's pocket actually consisted of two parts: the first was just ten per cent of the amount of the profits which the enterprise was required by the state plan to fulfil; and the second part was the amount of profits which were deemed to be excessive to the needs of the enterprise and its supervising government department. In contrast, the Chinese government ordered every state enterprise to pass all profits to the state. The funds were then repaid from the state budget to the enterprises in terms of the needs of the enterprises and of the possibilities for the distribution of financial resources in an area or industry as a whole. Therefore, the differences between China and the Soviet Union lay in both the process of profit distribution and the amount of profits being distributed. But in terms of productivity and economic efficiency, the Chinese system simply failed to provide proper incentives to enterprises. It failed because it removed the direct link between profits which an enterprise had made and

inefficiency and loss of state revenue. See Education Department of the Ministry of Finance, Zhongguo de Caizheng Gaike (China's Financial Reform), Beijing University Press 1988, pp.66-7.

¹⁵ For a comparison, see Li Cha, Zhonggong Shuishou Zhidu (Taxation System in Communist China), Youlian Institute Press (Hong Kong) 1969, pp.174-78.

the amount it could expect to retain for its own use. And even more unfortunately, in the late 1950s, after the breakdown of the Sino-Soviet relations, the Chinese government sought to justify its policy by openly criticising the Soviet style on the ground that the latter was excessively concerned with material incentives, thus following the erroneous "revisionist"¹⁶ way.

The system for the distribution of enterprise profits between the 1950s and 1977 in China is usually described as tongshou tongzhi, literally "unified income and unified expenditure". Under such a system, a state enterprise first paid industrial and commercial taxes. Income tax was not applicable to state enterprises which had to transfer their total profits to the state budget. The state would compensate for losses any enterprise had sustained. And the capital which an enterprise needed for expanding production could only come from the state budget.

It must, however, be mentioned that, in order to provide certain material incentives for the enterprise, during the periods of 1952-1957 and 1962-1968, the Chinese government tested an enterprise bonus system. Under this system, an enterprise could expect to receive a limited bonus if it overfulfilled profit quotas prescribed in the state plan. However, what seems to be more close to the idea of enterprise financial autonomy is the profit-sharing system that operated between 1958 and 1961. At that time, a government department might, according to the quotas fixed by its superior government offices, set the rate by which an enterprise under its supervision could share out all profits that the enterprise made. It was estimated that the average rate for the profit-sharing by enterprises during those four years was 10.2 per cent of the total profits made by relevant

¹⁶ The term "revisionist" was used to refer to a way which was condemned to be against traditional Marxist theory.

enterprises.¹⁷ Nevertheless, these tests were only exceptions to the general principle of tongshou tongzhi.

The above brief review of the distribution of enterprise profits in the PRC shows that before 1977, state enterprises did not have any significant degree of financial autonomy. The highly centralised distribution system was very convenient for the state and government authorities. This was because that the government authorities, by simply requiring state enterprises to hand over all their profits to the state, did not have to worry about making detailed rules for the collection of enterprises' income. In making decisions for allocating funds to enterprises, government authorities enjoyed great and arbitrary powers. However, this centralised distribution system failed to recognise the distinction between taxation and direct profit payments. The state remained both the owner and the direct manager of all state enterprises. Moreover, the role of enterprise' financial autonomy was ignored. Accordingly, the centralised system provided little incentive for enterprises to pursue economic efficiency. On the other hand, enterprises did not have to take financial responsibility since the government would always make good all the losses suffered by enterprises. As such, responsibility system did not exist.

From the legal point of view, the rigid regime simply ruled out any possibility for bargaining between an enterprise and its supervising government department or departments (except between 1958 and 1961 when a profit-sharing system was applied, as explained above). Unfortunately, the national economy sacrificed economic efficiency as the cost of this rigid regime. A more attractive system of profit distribution therefore had to be designed to combine rigid tax laws and rules, and yet provide flexible material incentives for enterprises. The Chinese economic reforms initiated in 1978 have been exploring ways to create such a regime.

¹⁷ See China's Financial Reform, supra note 14, p.95.

B. Enterprise fund and profit-sharing systems: 1978-1983

The reforms concerning the financial autonomy of state enterprises has been made one of the top priorities in China's post-Mao economic policies. In 1978, some state enterprises were allowed to withdraw "enterprise fund" (qiye jijin)¹⁸ out of their annual profits. To qualify for a withdrawal of enterprise fund, an enterprise had to realise certain targets and indexes prescribed in the state plans. Initially, these targets and indexes included: annual output; types and specifications of products; quality of products; consumption of raw and processed materials, fuel and power; labour productivity; costs; profits (including realised profits and profits turned over to higher authorities); turnover of working capital and fulfilment of supply contracts.¹⁹ However, in 1979, the number of targets and indexes was reduced to just four, namely, annual output; quality of products; profits; and fulfilment of supply contracts. An enterprise which had accomplished all four targets would be entitled to collect as enterprise fund up to as much as five per cent of its total annual wages bill for workers. An enterprise which failed to fulfil all the four targets but nevertheless succeeded in realising profits quotas imposed by state plans, could still collect enterprise fund of 1.25 per cent of its total annual wage bill for workers, for each of the four targets it had actually carried out. An enterprise which failed to fulfil profits quota set by state plans was deprived of the right to

¹⁸ See "Guowuyuan Pizhuan Caizhengbu Guanyu Guoying Qiye Shixing Qiye Jijin de Guiding" (Ministry of Finance, as approved by the State Council, Regulations Regarding the Experimentation of Enterprise Fund System in State Enterprises, Nov.25, 1978), in Selected Enterprise Laws and Regulations, pp. 319-21. The Regulations were later amended by the Ministry of Finance on Oct.17, 1979 in "Guanyu Gaijin Guoying Qiye Tiqu Qiye Jijin Banfa de Tongzhi" (Circular Concerning Improving Measures Used by State Enterprises to Draw Enterprise Fund), ibid, pp.337-41.

¹⁹ The fulfilment of supply contracts was important because it was one of the major ways to implement state economic plans.

withdraw enterprise fund. Moreover, enterprise fund had to be invested in the construction of workers' welfare equipment such as housing facilities. In addition, enterprises might also collect enterprise fund out of the profits exceeding the previous year's total profits. This part of the enterprise fund could only be used in production and technology innovation.

The enterprise fund system was, however, short-lived and only applied for approximately two years. Even in 1979 when this system was widely applied, some enterprises were selected to experiment with a new profit-sharing system,²⁰ which was similar to -- and given the same name as -- the system that operated between 1958 and 1961. The objective of this reform was to provide enterprises with opportunities to participate in greater profit-sharing. Until 1981, at least five different measures were employed for different enterprises. One was to share out profits exceeding the base amount as well as those exceeding the previous year's amount. The second was to share out all the profits which an enterprise had made. The third was to share out the profits exceeding those set by the state. The fourth was to share out profits exceeding those which had to be turned over to the state budget. The fifth applied to deficit enterprises only and involved sharing out the amount of loss-reduction.

In some respects, the profit-sharing system was similar to the enterprise fund system. In order to qualify for sharing profits, an enterprise had to realize four targets: annual output, product quality, annual profits, and the fulfilment of supply contracts. The profits retained by enterprises had to be used for special purposes, including production development, workers' welfare, and workers' bonus.

The most difficult and controversial issue facing the profit-sharing system was the way by which profit-sharing

²⁰ "Guanyu Guoying Qiye Shixing Lirun Liucheng de Guiding" (Provisions Concerning the Implementation of Profit-Sharing System by State Enterprises), promulgated by the State Council on July 13, 1979. See the text in Chinese, in Laws and Regulations of the PRC (1979), pp.253-55.

rates were determined. Generally speaking, the rates were to be set through gradation. In practice, such gradation took two steps:

The profit sharing rate for each province, municipality, autonomous region and central government department shall be set by the Ministry of Finance; and then within the set rates, each province, municipality, autonomous region and central people's government department shall respectively decide the profit-sharing rate for every enterprise under its supervision.²¹

Accordingly, the profit-sharing rate, which would in principle be applied for at least three years, could vary considerably in terms of region, department and indeed enterprise. The main consideration for such flexibility was that each enterprise was confronted with its own particular set circumstances because of the irrationalities in the supply of materials, in pricing policies and in many other factors. And for this reason, it would be grossly unfair if all enterprises were put under a single rate for profit sharing. In fact, at that time, and indeed even at present, external environment and internal circumstances vary considerably from enterprise to enterprise. Some enterprises have little difficulty in making huge profits, but others are never profitable.

In an attempt to equalise profitability among enterprises, the government implemented a discriminatory rate policy which operated to lower profit margins for highly profitable enterprises and to increase profit margins for struggling enterprises. However, the outcome deriving from such discrimination, as well as variable base profit figures, proved to be highly unacceptable. First, due to the existence of the above mentioned irrational factors, some enterprises could benefit greatly even if the rate for their share of profits was set at a low level. But others had to suffer despite endeavouring to enhance efficiency. Consequently, complaints were inevitable. Secondly, the possibility of negotiating for favourable profit-sharing rates blocked, rather than helped, the implementation of the policy of

²¹ Ibid. par.3.

separating government administration from enterprise management in financial matters. Instead of providing enterprises with financial autonomy, the profit sharing system operated to strengthen the position of government departments in charge of enterprises. An enterprise which had better relations and succeeded in its negotiations with government departments could expect to hand over less, and to retain more, of its profits. In addition, enterprises were again put under tight control from regional and departmental governments which were allowed to retain some of the profits handed over by enterprises under their supervision. Finally, and very importantly, one of the original purposes for implementing the profit-sharing system was to encourage the efficiency of enterprises by breaking up the so-called "big rice bowl" system in which inefficient enterprises received favourable protection. Although some enterprises did sincerely pursue this objective, many were able to escape from liability for inefficiency and bad management since the base profit figure could always be lowered by supervising government departments. Even worse, no liability was incurred for those enterprises which even failed to fulfil lowered base figures.

II. Tax Reform: 1983-1987²²

The enterprise fund and the profit sharing systems to some extent shook the old regime of tongshou tongzhi. In particular, the independent economic interests of enterprises were given recognition. However, as analyzed above, the profit-sharing system did not eliminate the adverse interdependent relationships between enterprises and their supervising government departments. The great flexibility of the system not only permitted the manipulation of base profit figures but also encouraged enterprises' dependence on

²² For a description and assessment of this period of the tax reform, see Yang Xiaoping, "Progress and Problems in the Development of a New Income Tax System for State-Owned Enterprises in China", in Journal of Chinese Law, Vol.3, Summer No.1 1989, pp.95-115.

government authorities. Moreover, the reliance on direct profit payments, rather than taxation, was a continuation of the previous and defective practice. Therefore, further reform was needed.

A. Initial period

In 1980, almost at the same time as the profit-sharing system was initiated, the State Council decided to choose some five hundred state industrial enterprises located in eighteen provinces and municipalities to experiment with a new system in which profits payments were replaced by tax payments.²³ Those selected enterprises were instructed to pay to the state not only occupation fees for both fixed and working capital but also taxes -- including industrial and commercial tax, adjustment tax, income tax and city construction tax. The profits after the payments of these taxes and fees would be retained by enterprises for the purposes of production expansion and workers' collective welfare facilities as well as workers' bonuses which should be restricted to be less than twenty per cent of the total retained profits. As such, the experimentation paid considerable attention to taxation. Income Tax was reintroduced and applied to state enterprises. In addition, an "Adjustment Tax" (tiaojie shui) was introduced for the first time in the history of the PRC. This type of tax was intended to adjust the inequality existed between enterprises, mainly caused by external economic and administrative forces beyond enterprise control, such as the irrational state pricing system. The rate of Adjustment Tax for an enterprise was determined in accordance with a proportion between the profits to be retained by the enterprise after payment of City Construction Tax and Income tax, and the total income of the enterprise concerned. As a

²³ On Sept.10, 1980, the Income Tax Law of the PRC Concerning Sino-Foreign Equity Joint Ventures was adopted. For the text in English, see China's Foreign Economic Legislation, Vol.1, Foreign Language Press (Beijing) 1982, pp.36-40.

result, the Adjustment Tax rate varied from enterprise to enterprise. And this characteristic made this type of tax unique among the various taxes.

In 1983, an important decision was made to "convert profit payments into tax payment" (li gai shui, hereafter the "Conversion"). The ultimate objectives of the Conversion can be described as: enterprises would pay taxes, and only taxes, to the state; all the profits after taxes would be retained by enterprises which would be entitled to use the retained profits autonomously. The Conversion was arranged into two steps. The first stage, between January 1983 and September 1984, was a period of coexistence of profit payments and taxation. Although enterprises were asked to pay taxes, direct profit payments from enterprises continued to be an important source for the state revenue. The second step started in October 1984 and was aimed at radical conversion by which the state would only levy taxes from state enterprises.

On April 29, 1983, the Ministry of Finance promulgated the Trial Measures Concerning the Conversion of Profits to Taxes in State Enterprises.²⁴ This document set forth a basic framework for the first stage of the Conversion. An Income Tax, as a significant part of the financial contribution from enterprises to the state, was firmly established. All large and medium-sized profitable enterprises had to pay Income Tax at a single rate: fifty-five per cent of all their incomes. The profits after the payments of Income Tax should be redistributed between the state and enterprises. Enterprises could retain a certain amount of profits in accordance with the quotas arranged by the state. The remaining part of the profits would be turned over to the state in four different ways -- depending on the specific situation, especially the profitability of an enterprise in question. These ways were: (1) increased progressive payments; (2) payments at a fixed rate; (3) payments in the form of Adjustment Tax; and (4) payments in a fixed amount (only applied to mining

²⁴ See the text in Chinese, in Bulletin of the State Council (1983), pp.584-88.

enterprises). In contrast, for small profitable state enterprises, Income Tax was based on eight graduated rates ranging from seven per cent on the first 1,000 RMB Yuan of taxable income to a maximum rate of fifty-five per cent over the portion of taxable incomes exceeding 200,000 Yuan. After the payment of taxes, all enterprises had to be responsible for their own financial affairs and the state would no longer allocate funds to them. But for those enterprises whose profits after taxation were still significant, the state could collect either contracting fees or a fixed amount of profits from enterprises.

B. Second period

The second step for the Conversion started in late 1984, the same year as the Chinese urban economic reforms commenced. After 1984, state enterprises would no longer directly make direct profit payments to the state. Instead, the imposition of eleven types of taxes was proposed.

The present industrial and commercial tax shall be divided, in terms of taxpayers, into Product Tax, Value Added Tax, Salt Tax and Services Tax. Both Income Tax and Adjustment Tax which have already been established in the first step of the Conversion shall be improved. And Resource Tax, City Preservation and Construction Tax and Vehicle and Boat Use Tax shall be introduced.²⁵

In September 1984, the Standing Committee of the National People's Congress adopted a Decision which authorised the State Council to issue relevant draft tax regulations for trial application.²⁶ This showed that the Chinese authorities

²⁵ "Guoying Qiye Dierbu Li Gai Shui Shixing Banfa" (Trial Measures Concerning the Second Step of the Conversion by the State Enterprises), drafted by the Ministry of Finance, approved by the State Council on Sept.18, 1984. See the text in Chinese, in Laws and Regulations of the PRC (1984), pp.224-31, par.1.

²⁶ See "Decision of the Standing Committee of the NPC on Authorising the State Council to Reform the System of Industrial and Commercial Taxes and Issue Relevant Draft Tax Regulations for Trial Application", in The Laws of the People's Republic of China (1983-86), Foreign Language Press

had begun to pay serious attention to the large scale legal regulation over the tax reforms. Many regulations and draft regulations have since been promulgated by the State Council as a guidance for implementing the Conversion. The proposed eleven types of taxes and their application are briefly discussed below.

First, Income Tax is significant.²⁷ As at the first stage of the Conversion, all large and medium-sized profitable state enterprises pay fifty-five per cent of their incomes to the state revenue. However, the eight graduated rates which formally applied to small profitable enterprises²⁸ were amended. The present range is from ten per cent to fifty-five per cent. Moreover, the amounts of taxable incomes for small enterprises were also significantly increased.

Secondly, there were minor changes to Adjustment Tax. In order to determine an Adjustment Tax rate for an enterprise, a base figure has to be settled. This base figure is calculated on the basis of the enterprise's realised profits in 1983, after balancing any possible changes following the varied rates concerning Product Tax, Value Added Tax and Service Tax, and after the introduction of Resources Tax. The formula for determining the Adjustment Tax base rates is: Base Rate = {Base Profits in 1983 - (imputed Income Tax + Retained Profits as approved in 1983)} / Base Profits.²⁹ In addition, an enterprise's incremental profits are only subject to

(Beijing) 1987, p.150.

²⁷ See "Zhonghua Renmin Gongheguo Guoying Qiye Suodeshui Tiaoli Caoan" (the PRC Draft Regulations on the Income Tax of State Enterprises), promulgated by the State Council on Sept.18, 1984, effective from Oct.1, 1984, in Ministry of Finance, Caizheng Faqiu Gongzuo Shouce (Work Handbook on Financial Laws and Statutes, hereafter "Handbook"), China Financial and Economic Press (Beijing) 1988, pp.126-30.

²⁸ The criteria for judging a small enterprise were also relaxed. Many previously labelled large or medium-sized enterprises were degraded into small enterprises and as a result they might pay less taxes.

²⁹ See Yang Xiaoping, supra note 22.

reduced Adjustment Tax rate. The formula applied is:
Incremental Rate = Base Rate x (1-70%).³⁰

Thirdly, until the time of the writing, Household Property Tax, Land Use Tax and Vehicle and Boat Use Tax have not been put under any formal regulations. Actually they only exist nominally. There, however, have been detailed regulations on Product Tax,³¹ Value Added Tax,³² Service Tax,³³ Salt Tax,³⁴ Resources Tax³⁵, and City Preservation and Construction Tax.³⁶

It is noteworthy that the above-mentioned taxes do not contain all the taxes which enterprises have to pay. In fact, Animal Slaughter Tax, Special Oil-Consuming Tax, Agricultural and Animal Husbandry Tax, Bonus Tax, and Adjustment Taxes for

³⁰ "Zhonghua Renmin Gongheguo Guoying Qiye Tiaojieshui Zhenshou Banfa" (PRC Measures for the Collection of State Enterprises Adjustment Tax), State Council, Sept.18, 1984, effective from Oct.1, 1984 (Art.7), in Handbook, supra note 27, pp.131-4.

³¹ "Zhonghua Renmin Gongheguo Chanpingshui Liaoli Caoan" (The PRC Draft Regulations on the Product Tax), in Handbook, supra note 27, pp.79-100.

³² "Zhonghua Renmin Gongheguo Zengzhishui Liaoli Caoan" (The PRC Draft Regulations on Value Added Tax), in Handbook, supra note 27, pp.103-7.

³³ "Zhonghua Renmin Gongheguo Yingyeshui Liaoli Caoan" (The PRC Draft Regulations on Services Tax), in Handbook, supra note 27, pp.109-13.

³⁴ "Zhonghua Renmin Gongheguo Yanshui Liaoli Caoan" (The PRC Draft Regulations on the Salt Tax), in Handbook, supra note 27, pp.115-9.

³⁵ "Zhonghua Renmin Gongheguo Ziyuanshui Tiaoli Caoan" (The PRC Draft Regulations on Resources Tax), in Handbook, supra note 27, pp.121-24.

³⁶ "Zhonghua Renmin Gongheguo Chengshi Weihu Jianshe Shui Zanxing Tiaoli" (PRC Provisional Regulations on City Preservation and Construction Tax), promulgated by the State Council on Feb.8, 1985, in Handbook, supra note 27, pp.182-83.

the Orientation of Investment on Fixed Property³⁷ are also collected in accordance with existing legislation. In addition, since January 1, 1983, state enterprises, together with other entities, have been required to make contributions to key energy and transportation projects.³⁸

The combination of all these types of taxes have made the taxation for state enterprises a very complex system. For the purpose of this discussion, it is neither possible nor necessary to describe this complex system in great detail. It is, however, interesting to compare the tax treatment for state enterprises with that for other types of enterprises. Such a comparison will serve both to explore the official objectives of the tax reforms and to explain the difficulties facing the reforms. Indeed, it was these difficulties that led to a decisive policy shift in 1987.

First, most taxes, except a few, such as Income Tax, Adjustment Tax and Bonus Tax, provide equal treatment for all types of enterprises. State, collective, private, and foreign investment enterprises have to pay at the same rate on the Product Tax, Value Added Tax and many other taxes. This tax equalisation between different enterprises regardless of their property ownership demonstrated the somewhat determination of the Chinese government to unify taxation of all enterprises within the territory of the PRC.

Secondly, significant differences exist in the treatment of Income Tax between different enterprises. All large and medium-sized state enterprises have to pay fifty-five per cent of their taxable incomes. In contrast, the Income Tax rates

³⁷ Promulgated by the State Council on Apr.16, 1991 and effective as of 1991. For the main text in Chinese, see XHYB, No.5, 1991, pp.64-5. This type of tax which replaced the previously applied Construction Tax is aimed to implement the state's "industrial policy" (chanye zhengce) which from time to time puts emphasis on some industries and discriminates against others.

³⁸ "Guojia Nenyuan Jiaotong Zhongdian Jianshe Jijin Zhenji Banfa" (Measures Concerning the Collection of Key State Energy and Transportation Projects). Issued by the State Council on Dec.15, 1982, in Handbook, supra note 27, pp.21-5.

for collective enterprises³⁹ are calculated at graduated bases ranging from ten per cent to fifty-five per cent. These rates are exactly the same as those for small state enterprises. Therefore, a demarcation exists not only between state enterprises and collective enterprises, but also between large and medium-sized state enterprises and small state enterprises. The fact that large and medium-sized enterprises have to pay more to the state reflects a deep concern of the Chinese government over the role that they should play. The underlying formula has been described as that "the state gets the most, enterprises get less, and individuals get the least". The primary aim of this socialist formula is to enable the state to obtain a steady and guaranteed amount of incomes from large and medium-sized state enterprises. But the discriminatory treatment of income taxes for different enterprises has caused concern over state enterprises' ability to compete with other types of business entities in a socialist economy which purports to combine both market forces and state planning. Large and medium-sized state enterprises have to bear the unreasonably heavy burden of Income Tax. Moreover, discriminatory treatments are based on the size of state enterprises, rather than the amount of taxable income or other criteria. Although the Chinese government in 1984 relaxed the criteria for defining "small enterprises", thus characterising more state enterprises as "small" ones for the purpose of income taxation, the discrimination of Income Tax appears not to be helpful in encouraging all enterprises to make as much profits as possible. An enterprise which has made more profits is not necessarily entitled to retain more. In addition, the difference is also apparent in the income taxation between state enterprises and foreign investment enterprises. For example, Sino-foreign equity joint ventures must pay only thirty per cent of taxable incomes, plus three

³⁹ "Zhonghua Renmin Gongheguo Jiti Qiye Soude shui Zanxing Tiaoli" (PRC, Provisional Regulations on the Income Tax of Collective Enterprises). Promulgated by the State Council on Apr.11, 1985, in Handbook, supra note 27, pp.136-39.

per cent of local tax.⁴⁰ Consequently, there have been calls for the unification of income taxation for all enterprises within the PRC, whatever their property ownership.

Thirdly, Adjustment Tax is unique to state enterprises. It was thought that this kind of tax would balance the financial inequalities between enterprises by taking more from the more profitable enterprises. But the result have not been as good as one might have expected. Although the state has set certain rules for determining the Adjustment Tax rate for each enterprise, the fact that each enterprise has its own special rate has caused problems. Most notably, the Adjustment Tax gives government authorities great discretionary power. The Measures for Collecting Adjustment Tax⁴¹ provide that the rate shall be settled through negotiations between competent government financial and taxation departments and the government departments in charge of the enterprise concerned. Such a process means not only flexibility but also uncertainty. Moreover, enterprises continue to be dependent on government authorities which are free to determine the rates of the Adjustment Tax.

When the Conversion was proposed in 1983, the Ministry of Finance singled out five advantages for this Conversion.⁴² These included, incentive for enterprises to retain more by making more profits; fixed rate for the distribution of

⁴⁰ The taxation on all foreign investment enterprises, including equity and cooperative joint ventures, and wholly foreign-owned enterprises, has been unified by the PRC Income Tax Law on Foreign Investment Enterprises which was adopted by the NPC on Apr.9, 1991 and effective from Jul.1, 1991. For an English translation, see China Law and Practice, No.3, Apr.15, 1991, pp.25-35. See Art.3.

⁴¹ Supra note 30, Art.5.

⁴² "Guowuyuan Pizhuan Caizhengbu Guanyu Quanguo Ligaishui Gongzhuo Huiyi De Baogao He Guanyu Guoying Qiye Ligaishui Shixing Banfa De Tongzhi" (The Ministry of Finance's Report, as approved and noticed by the State Council, on the National Work Conference on the Conversion and the Trial Measures Concerning the Conversion of State Enterprises), Apr.24, 1983. See the text in Chinese, in Laws and Regulations of the PRC (1983), pp.137-47, at p.139.

profits between the state and enterprises; breaking up of the limitations imposed by various government departments and regions; the use of economic leverage; and proper financial income for state enterprises and individuals. These hopes, however, have proved to have been partially realised. For example, the flexible Adjustment Tax has undermined the rigidity of tax laws and affected the incentive for enterprises which must pay more if they make more profits. Again, the simplified and high Income Tax rate for large and medium-sized state enterprises has threatened the functioning of taxation as a kind of economic leverage. Thus, the tax reform starting from 1983 has met difficulties in achieving the aims set out by original designers.

Significant credit must, however, be given to the tax reforms. At least, taxation is no longer reserved for non-state enterprises. Like other enterprises, state enterprises are now subject to many types of taxes, including income taxes. Nevertheless, this reform has overemphasized the role of taxation on state enterprises. It was thought that state enterprises, like other enterprises, would pay only taxes to the state which would no longer collect profits from enterprises in any other way. Accordingly, a high Income Tax rate was set for large and medium-sized state enterprises. Even if one disregards the above described negative effects of such a high rate, this treatment is not without question. A fundamental and theoretical issue is that "tax" (shui) and "profits" (li) are again being confused. As far as state enterprises are concerned, levying taxation and direct profit payments in the single form of extremely high rate for Income Tax fails to take into account the differences between shui and li. The state, as the social administrator, can levy various taxes on state enterprises. But the exclusion of any direct profit payments after taxation shows an ignorance of the state's status as the sole investor of state enterprises. In this sense, the tax reforms represent an unsuccessful move towards fixing a fair formula for the distribution of enterprise profits between the state and enterprises.

III. Tax Reform After 1987

A. Impact of the contracting system

Since 1987, the most significant policy change has been the large scale implementation of the "contracting" (chengbao) system -- a subject to be examined in detail in Chapter Nine. Under this system, a state enterprise is required to sign with government authorities a chengbao contract which assigns many targets to the enterprise. According to the Provisional Regulations Concerning the Contracting Management Responsibility System in State Industrial Enterprises ("Chengbao Regulations"),⁴³ financial turnover from enterprises to the state is one of the three main contents of the chengbao contract.⁴⁴ The profits which an enterprise must hand over to the state are called "profit target" (shangjiao mubiao renwu or chengbao mubiao). This target must be settled before a chengbao contract is concluded. In fact, a chengbao contract does not take effect until the superior financial authorities have given their consent to the profits target.⁴⁵

The main components of the profit target have been subject to several changes. In 1987, the required targets

⁴³ For the text in Chinese, see Law and Regulations of the PRC (1988), pp.735-44.

⁴⁴ Ibid. Art.8. The other two contents are the completion of technological transformation tasks and the linkup of the payroll with economic effectiveness.

⁴⁵ See "Caizhengbu Guanyu Guoying Dazhongxing Gongye Qiye Tuixing Chengbao Jingying Zerenzhi Youguan Caiwu Wenti de Zanxing Guiding" (The Ministry of Finance, Interim Provisions on the Implementation of the Chengbao System in Large and Medium Sized State Industrial Enterprises, Aug.21 1987, hereafter "Interim Provisions"), par.4. See the text in Chinese, in Laws and Regulations of the PRC (1987), pp.344-47. Also see "Quanmin Suoyouzhi Gongye Qiye Tuixing Chengbao Jingying Zerenzhi Youguan Caiwu Wenti de Guiding" (Provisions on the Implementation of Chengbao System in State Industrial Enterprises, Apr.27, 1988, hereafter "Provisions"), par.5. See the text in Chinese, in Bulletin of the State Council (1988), pp.852-55.

referred to Income and Adjustment Taxes only.⁴⁶ But since 1988, the target has been extended to include also a certain amount of profits.⁴⁷ For those enterprises which have chosen to pay Income Tax separately, the target may only include Adjustment Tax and profits. But this type of situation is not significant and therefore is not the main subject of the present discussion.

It has been repeatedly emphasized that the profit target must in no way include taxes other than Income and Adjustment Taxes.⁴⁸ Therefore every enterprise must pay Product Tax, Value Added Tax, Service Tax and many other taxes in accordance with relevant laws. In fact, an enterprise has to pay not only these taxes but also Income and Adjustment Taxes as well. Although profit target may include, inter alia, Income and Adjustment Taxes, a difference in the amount of taxes always exists between the figure written in a contract and the sum that an enterprise finally pays to the state at the end of a financial year and in accordance with tax laws. Both Income and Adjustment Taxes figure as fixed in a chengbao contract is just a basis which an enterprise must pay. An enterprise may have to pay, according to tax laws, either more or less than the figure arranged in a chengbao contract, depending on the productivity, economic efficiency, market, and many other factors.

The profit target varies from enterprise to enterprise and even from year to year for an industrial enterprise. According to the Chengbao Regulations,⁴⁹ the main forms of enterprise profit payment include: (1) progressive increases in profit payments to the state; (2) fixed amount of payment to the state, with the excessive part being shared by both the state and enterprises; (3) fixed payments to the state; and

⁴⁶ Interim Provisions, ibid, par.3.

⁴⁷ Provisions, supra note 45, par.2.

⁴⁸ Interim Provisions, par.3; Provisions, par.2. Both in supra note 45.

⁴⁹ Art.9. Supra note 43.

(4) loss reduction. Of these four forms, "loss reduction" is the only one which applies to deficit enterprises. The target of these deficit enterprises is to reduce every year a certain proportion of the losses. The amount of profits which is above the target amount belong to the enterprises rather than the state. However, enterprises which have relatively small profit margins may choose to pay a fixed proportion of its profits to the state. As a result, these enterprises are allowed to retain the profits exceeding this fixed amount.

In contrast, forms (1) and (2) are more complicated because the payment amount is relatively uncertain. The starting point is to settle a base payment figure. In 1989, this figure was fixed at no less than the total amount of Income and Adjustment Taxes which an enterprise was supposed to pay in 1986.⁵⁰ Subsequent to the change made in 1988, the base figure should now be no less than the total of Income and Adjustment Taxes and certain amount of the profits. For some enterprises, these base figures are fixed. And profits which are above these base figures will be shared by both the state and enterprises themselves on a proportional basis. For others, the base figures may only be their profits target for the first year of the contractual term. The profit target for the consecutive years within a chengbao term will be increased progressively.

The profits target, whether fixed or not, is relatively easy to define. As indicated above, these figures are merely reference bases. Whatever the profit target or base figure (as the case may be) is, every enterprise has to pay taxes to the state in accordance with the law. By the end of a financial year, if the total amount of taxes to be paid by an enterprises Income and Adjustment Taxes exceeds the profit target prescribed in a contract, then the government financial department will return the above-target part to the

⁵⁰ Some enterprises may choose an average figure of the previous years' payment as the base figure. See Provisions, supra note 45, par.4.

enterprise.⁵¹ For example, if the profit target for an enterprise in 1991 set in a contract is five million Yuan, and if the enterprise has actually paid six million Yuan in Income and Adjustment Taxes in 1991 in accordance with the law, the enterprise would be eligible to withdraw from relevant government financial departments one million Yuan, that is, the above-base figure amount. On the other hand, if an enterprise fails to turn over the exact amount of the profit target as settled in a chengbao contract in the form of Income and Adjustment Taxes, the enterprise, according to the law, is obliged to make up for the deficit from its own capital. In the above example, if the enterprise actually paid 4.5 million Yuan in taxes, then it had to pay to the state 0.5 million Yuan out of its own financial reserves.

As a result, the overall effect which the current chengbao system has made on the post-1983 tax reforms is something of a compromise between the radical approach (ie. taxation or shuishou) and the traditional approach (ie. profit payment or lirun shangjiao). On the one hand, the profit target as settled in advance in a chengbao contract is in essence the amount of the profits paid by an enterprise to the state. Although the target appears to include in most cases both Income and Adjustment Taxes, these taxes are symbolic rather than essential and compulsory. This is mainly because the taxes included in a contract represent just the record and amount of the previous year(s). Moreover, an enterprise may actually pay an amount in taxes which is either more or less than the amount recognised in a contract. Since 1988, the symbolic nature of the profit target in a chengbao contract has been made more obvious as for most enterprises a certain amount of the profits in addition to original taxes must be included in the profit targets.

Taxation rules established in the tax reform have been

⁵¹ Actually the account is settled every three months, and eight per cent of the above-target part will be returned immediately to the enterprises. See Provisions, Supra note 45, par.6.

maintained. Enterprises continue to pay many taxes, including Income and Adjustment Taxes. However, because the amount of the profit target is always fixed, taxation under the chengbao system has been distorted. An enterprise must pay taxes to the state, but it is entitled to retain the amount of taxes which is above the profits target as provided in a contract. Therefore the "gratis nature" (wuchangxing) of taxation is no longer true under the chengbao system. Moreover, since the profits target may include profits as well as taxes, and since an enterprise usually pays only Income and Adjustment Taxes to cover the profit target, lirun (profit payment) and shuishou (taxation) have again been mixed. In fact, the Chinese authorities have deliberately used the term "profit target" (lirun zhibiao) rather than "tax target" (shuishou zhibiao) in contracts. Furthermore, the high rate (55%) of Income Tax for large and medium-sized state enterprises originally set in the tax reforms between 1983 and 1987 has made the confusion between taxation and profits both possible and necessary. The state has paid more attention to its income than to the way through which its revenues are collected. As a result, the present practice does not differ significantly from the old system in which direct profit payments were regarded as a more important means for settling the financial relationship between the state and state enterprises.

B. A new system

Since 1988, the Chinese government has decided to experiment with in pilot areas a new system described as shui li fenliu, shuihou huandai, shuihou chengbao, literally "separating taxes and profits payments, repaying enterprise loans after taxation, and contracting after taxation."⁵² The

⁵² For a report on this new system, see "China Tries Out Reform in Payment of Taxes", China Daily, Jul.22, 1991, p.3.

new system will bring some changes to the existing practice.⁵³ First, taxation and profit payments are separated. The profit target in a chengbao contract includes only profit payments after income taxation. Rather like the practice concerning government enterprises in the West, Chinese state enterprises under the new trial system first pay many types of taxes to the state in accordance with relevant laws. These taxes include Income Tax. After the payment of tax, the profits made by state enterprises are divided into two parts. One part is to pay the profit target as settled in advance in a chengbao contract. The remainder is retained by the enterprise.

Secondly, the new system requires a substantial lowering of the Income Tax rate. All profitable state enterprises will pay income tax at a unified rate of thirty-three per cent of their total taxable income.⁵⁴

Thirdly, Adjustment Tax will be abolished.⁵⁵ The balance of profit margin between enterprises of different profitability will be maintained through the chengbao after taxation. The ways to realise such chengbao targets may be the same as those provided by the Chengbao Regulations. But the amount of profit targets may be significantly smaller as tax payments have been excluded from this amount.

Fourthly, enterprises which are experimented with the new system may only use their after-tax profits to repay bank loans used for fixed assets investment.⁵⁶ In contrast with the popular practice whereby enterprises may repay bank loans with their gross profits, this measure under the new trial system

⁵³ On Aug.14, 1991, The Ministry of Finance and the State Commission for Economic System Reform jointly promulgated the "Measures for Experimenting with the shui li fenliu, shuihou huandai, shuihou chengbao in State Enterprises". For the text, see Zhonghua Renmin Gongheguo Xinfagui Huibian (Collection of New Legislation of the PRC), China Legal System Press (Beijing), No.3, 1991, pp.118-24.

⁵⁴ Section 1, par.2, ibid.

⁵⁵ Section 1, par.4, ibid.

⁵⁶ Section 1, par.3, ibid.

is mainly aimed both at making enterprises themselves solely responsible for their loan repayment and at increasing the income for the state revenue.

The practical implementation of the new system can be as complex as the previous chengbao system implemented since 1987. However, under the new system the distinctions between taxation and direct profit payments will be made clear. The state, as the social administrator, can levy taxes in accordance with tax laws. Being the owner and investor of the state enterprises, the state is also entitled to be paid "dividends" by enterprises. Such dividends and new chengbao targets are the components of the profit target currently included in most chengbao contracts.

This new system is still controversial. Even if this new system is eventually extended to all large and medium-sized state enterprises, it remains to be seen whether it will provide the appropriate mechanism for guaranteeing the financial autonomy for state enterprises. The manner in which the ratio for the distribution between the state and state enterprises of after-tax profits made by enterprises will be decided and properly fixed is very uncertain, and may not leave enterprises with full financial autonomy.

IV. Enterprise Capital and its Legal Nature

One of the most important results of the recognition of enterprises' independent interests has been the existence of enterprises' retained profits. These retained profits, however, have taken many forms. As described above, in 1978, it was permitted to withdraw enterprise fund. Although the subsequent profit-sharing system abandoned the term of "enterprise fund", it nevertheless recognised that enterprises could retain some profits from their contribution to the state. The current chengbao system again has made it possible that efficient enterprises may keep their own reserves up to a significant amount. From 1988, according to the Chengbao

Regulations,⁵⁷ enterprises which implement the chengbao system shall conduct the trial system of opening separate capital accounts. This involves separating the state capital and enterprise capital and entering them into different accounts. Therefore a division between state capital and enterprise capital must be made.

It is interesting to note that here the concept of "capital" (zijin), as distinct from "fund" (jijin), is used. Traditionally, "fund" refers to money reserved and employed for special purposes, while "capital" has a more general meaning so that it includes not only "fund" but also the value of assets and property. Therefore, under the enterprise fund system implemented in 1978 and 1979, the fund had to be invested and used for special purposes. But as far as accounting is concerned, neither the enterprise fund system nor the profit-sharing system required enterprises to open a separate account for the profits they retained. And it was not clear what was the difference, if any, between state capital and enterprises' retained capital. Apart from the rules governing the employment of the retained profits, there were no detailed regulations on the mixed use of the two. Thus, enterprises' retained profits were sometimes employed in the same way as state capital, or they were even absorbed into state capital.

The Chengbao Regulations seem to initiate a new regime on the accounting treatment. They set out the practical approaches for dividing state and enterprise capital:

All fixed assets and cash flow possessed by an enterprise before a contract comes into force shall be listed as state capital.

The portion of profits retained during a contract period as well as any fixed assets and supplementary cash flow brought in by such retained profits shall be listed as enterprise capital.

Fixed assets bought with borrowed funds during the contract period which are repaid with retained profits, shall be listed as enterprise capital. If the loan is repaid before tax, the capital shall be converted into state capital and enterprise capital, in accordance with

⁵⁷ Art.34. Supra note 43.

the proportion of profit distribution between the state and the enterprise before the contract comes into effects.

The depreciated funds of fixed assets withdrawn during the contract period shall be listed separately as state capital or enterprise capital in accordance with the proportion of fixed assets in respect of state capital and enterprise capital.⁵⁸

These complex rules to some extent reflect the Chinese government's concern over the introduction of the new separate accounts system. On the one hand, enterprise capital account shall have its sources of incomes. On the other hand, the state does not permit the state capital and assets to be transferred into enterprise capital account. Furthermore, the state's reluctance over the opening of the enterprise capital account has also been confirmed by the Chengbao Regulations in its assertion that enterprise capital is "owned by the whole people (quanmin suoyou)".⁵⁹ However, this assertion raises questions as to the status as well as the function of the enterprise capital.

The most important function of the enterprise capital is represented by their status as "risk funds" (fengxian jijin). The Chengbao Regulations provided:

Enterprise capital shall be treated as risk funds for any losses incurred by a contractual operation. When the contract is over, the capital shall be injected into the enterprise capital of the next phase of chengbao.

If an enterprise does not have enough profits to turn over the required amount to the state, it may make up the shortfall by using the profits that it retained that year; if this is not enough, it may use the enterprise capital.⁶⁰

The risk funds nature of the enterprise capital is deeply associated with the chengbao system. As explained in earlier discussion, when an enterprise overfulfils the profit target as fixed in a chengbao contract, it can retain a certain amount of the profits. These profits then enter into the

⁵⁸ Art.34. Supra note 43.

⁵⁹ See Art.34. Ibid. Quanmin suoyou is usually understood as guojia suoyou (state-owned).

⁶⁰ Art.35. Ibid.

enterprise capital account. However, some enterprises may fail to carry out their profit targets, and they must then pay the defaulting amount with their enterprise capital (if any), rather than with state capital. In such circumstances, the state requires enterprises to keep enterprise capital as a kind of security for chengbao contracts. Moreover, if an enterprise does not possess enough enterprise capital to satisfy the defaulting amount in comparison with the profit target, it must not use the state capital to make good the defaulting part. If the superior government departments do not relieve a defaulting enterprise of such deficit, the enterprise has to keep the record of the deficit and make good such deficit in the coming years.

In addition to its risk funds nature, the enterprise capital can also be seen as a reward for efficient enterprises. The enterprise capital may be used for production, welfare, bonus and many other purposes. Thus, enterprises and their workers, rather than the state, may directly benefit from the enterprise capital.

The legal nature of the enterprise capital is, however, controversial when enterprises' right to this sum of capital is discussed. As already analyzed in Chapter Three, according to the GPCL and the SEL, state enterprises enjoy the right of "management", rather than that of ownership, towards the assets and capital under their control. Nevertheless, the right of a state enterprise towards its enterprise fund is not clear.

Both the GPCL and the SEL were promulgated before the enterprise capital system was introduced. They could not foresee a division in the whole assets and capital of a state enterprise. Indeed, the GPCL and the SEL merely claim that a state enterprise has the right of management in respect of the property which the state has authorised it to manage. A problem arising from such a statement is whether "the property which the state has authorised an enterprise to manage" includes the enterprise capital. Here the major difference is, while the state capital existed before a chengbao contract

comes into effect, the enterprise capital does not take its form until an enterprise has successfully exploited "the property which the state has authorised it to manage".

The state, of course, can extend the concept of "authorised property" to include the "enterprise capital", therefore allowing an enterprise to have merely the management right to the whole property possessed by the enterprise. As indicated above, the state has shown a timid attitude towards the enterprise capital. On the other hand, enterprises themselves have been reluctant to draw a clear distinction between the state capital and the enterprise capital. For example, the Chengbao Regulations provide: "any loans obtained after a contract comes into force shall in principle be paid back with the enterprise capital."⁶¹ But in practice, it has been complained⁶² that many enterprises simply repay loans out of pre-tax profits. Since the majority of enterprise profits should, according to the law, be paid to the state revenue, the immediate result from the violation of the above described principle as prescribed in the Chengbao Regulations is a sharp decrease in the amount of state incomes. Enterprises, in doing this, have gained more than if they would have to repay loans out of their enterprise capital. This is mainly because the enterprise capital is merely a part of their after-tax profits, and enterprises would try to increase the enterprise capital at the cost of the state capital. This practice certainly threatens the interests of the state.

The ambiguous nature of enterprises' retained profits has casts a shadow on any reform in the profit distribution mechanism. The government faces a dilemma in the reforms. It allows enterprises to keep certain amount of profits but, at the same time, claims that these retained profits are owned by

⁶¹ Art.37. Supra note 43.

⁶² See Fu Fengfu and Chen Xingdong, "Shuili Fengliu, Shuihou Chengbao Shi Dui Chengbaozhi de Wanshan He Fazhan" (Separating Tax From Profits and Implementing Chengbao After Tax Are the Perfection and Development of the Chengbao System), in ZGJJTZGG, No.6, 1990, pp.7-9.

the state. In order to give material incentives to enterprises, the state may allow enterprises to use retained profits more flexibly, but it is deeply concerned with both the lack of growth in the state revenue and the increase of the value of the property from state investment.

The use by enterprises of their retained profits has been placed under strict state guidance. For example, in 1984, the Trial Measures Concerning the Second Step of the Conversion by State Enterprises provided:

The retained profits must be used and distributed properly by state enterprises. Enterprises must establish new product trial funds, production development funds, reserve funds, workers welfare funds and workers bonus funds. The proportion between workers bonus funds and the total retained profits shall be decided through negotiation between the Ministry of Finance and each province, municipality, autonomous region of (central government) department in charge of enterprises, which shall then set the proportional rate for enterprises at each level. Of all retained profits, fifty-five per cent must be invested for production development, twenty per cent for workers welfare and thirty per cent for workers bonus.⁶³

The Chengbao Regulations of 1988 did not provide a specific rate for the employment of retained profits. Instead, policy guidance was provided:

A chengbao enterprise shall examine and rectify the proportion of retained profits distributed to production development funds, welfare funds and bonus funds. It shall also channel certain sum of money from the welfare and bonus funds into housing system reform. Profits retained during the chengbao term shall principally be invested as production development funds.⁶⁴

As such, retained profits must in all circumstances be used first for production development, rather than welfare and bonus for workers. It is nevertheless true that under the new policy, efficient enterprises may be allowed to spend more on welfare and bonus than they did in the past. Moreover, enterprises may enjoy the autonomy, for example, in deciding the orientation and other important matters concerning

⁶³ Supra note 25, par.10.

⁶⁴ Art.36. Supra note 43.

production and development. However, from the standpoint of enterprises, the opening of state capital account appears to be less attractive than one might expect. Whatever amount of the enterprise capital, they are owned by the state. Efficient production is not very relevant for the interests of enterprises. Furthermore, because of the state ownership of the enterprise capital, enterprises can hardly defend themselves against excessive government intervention. On the other hand, the fact that the enterprise capital is not owned by an enterprise usually results in a situation in which such capital is illegally employed and exploited by the enterprise. In practice, this abuse may be reflected by enterprises' over-expenditure on welfare and on bonuses other than production and development. Despite the requirement that the enterprise capital must be reserved as risk funds for chengbao contracts, the capital is still state-owned. It does not make much difference whether the debts and liabilities of the enterprises are repaid with the enterprise capital or the state capital. Therefore, a mere division of the state enterprise capital has failed to promote the full financial autonomy of state enterprises. Nor has it operated to make enterprises themselves financially responsible for their management.

V. Conclusion

The financial autonomy of state enterprises is one of the key issues which the Chinese government has to consider very carefully in unfolding economic reforms. Indeed, frequent changes in the policies concerning the financial autonomy of state enterprises have underlined the objective difficulties in dealing properly with this issue as well as the subjective confusion existing within the minds of Chinese decision-makers.

In the financial reform of state enterprises, two questions must be answered very clearly. One is whether or not the state permits efficient enterprises to retain profits. And

the other is the ways in which the actual financial distribution between state enterprises and the state is put into effect.

As to the first question, the Post-Mao economic reforms have given affirmative answers. For most of the years prior to 1978, state enterprises were deprived of the right to retain any of the profits they made. But since 1978, successful enterprises are entitled to share profits with the state.

The answer to the second question is not satisfactory. The primary difficulty lies in the determination of the criteria for enterprises to participate in the profit-sharing. On the one hand, improvements have been made. The employment of taxation and tax laws represents a significant departure from the traditional dislike of imposing taxation on state enterprises. In particular, the introduction of Income Tax and many other taxes for state enterprises in 1983 and later years must be seen to some extent as an attempt by the Chinese authorities to resort to economic and legal, rather than administrative, methods in regulating financial affairs.

On the other hand, the use of law has met setbacks and challenges. Given the distinctive nature that the state stands as both the social administrator and the sole investor in state enterprises, the confusion over "taxation" (shuishou) and "profit payment" (lirun shangjiao) has so far not been properly resolved. The post-1983 tax reforms attempted to replace direct profit payments with taxation. However, this attempt was neither feasible nor radical. Consequently, instead of making general rules applicable to all enterprises, concessions and special treatments were made. In order to guarantee state incomes, a high Income Tax rate (55%) was imposed on large and medium-sized state enterprises. Moreover, in order to reduce the inequality of profitability between enterprises mainly due to irrational and unequal external conditions, the Chinese government has applied an Adjustment Tax which is negotiable and adjustable for each enterprise.

The current chengbao system is a significant setback for the tax reforms. Although enterprises continue to pay taxes in

accordance with tax laws, it is the profit target settled in a chengbao contract, not the tax payment, that decides the financial distribution between state enterprises and the state. Direct profit payments and taxation have again been confused. Moreover, both the negotiable Adjustment Tax and changeable profit target⁶⁵ have operated to make enterprises more dependent on government authorities. Such dependence and flexibility are precisely what the tax reforms starting in 1983 sought to overcome.

The consideration of economic interests is the most important factor which has forced the Chinese government to adjust its policies towards profit distribution between the state and state enterprises. The economic incentive that the state gives to enterprises by encouraging successful enterprises to share profits, however, usually accompanies the decrease of state revenue. As one commentator put it in 1984, given the inherent problems such as outdated machinery, equipment and products, and the low level of technical and managerial skill,

unless the malaise in the industrial system is eliminated, attempts to improve enterprise performance and put them to modernisation by material incentives such as profit sharing will be in vain.⁶⁶

The changing policies and underlying problems since 1984 has again proved this judgment does coincide with the Chinese practice. The ultimate incomes of the state are considered to be more important than the means through which this result is actually achieved (either direct profit payments or taxation).

An examination of the nature of enterprises' retained profits has cast shadow on the policy of enterprises' financial autonomy. Enterprises may have their own capital account, but like the state capital, the enterprise capital is

⁶⁵ This is partly due to the Adjustment Tax and partly due to the inclusion in the profit target of direct profit payments in addition to taxes.

⁶⁶ Sukhan Jackson, "Profit Sharing, State Revenue and Enterprise Performance in the PRC", in Australian Journal of Chinese Affairs, No.12, 1984, pp.97-112 at p.112.

also owned by the state. Despite the requirement that the enterprise capital to be used as risk funds for chengbao contracts, enterprises which have no property of their own bear little liability.

Taxation is an area in which considerable reforms have taken place since the commencement in 1984 of the urban economic reforms. It is also an area that will experience great changes in the future. Of the changes that are expected, the Chinese authorities have been committed to unify the tax treatment for all enterprises established in China.⁶⁷

In order to both protect state property and secure the financial interests of state enterprises, it has again been suggested -- even by some government officials -- that while the state should remain as the sole owner of the property operated by state enterprises, the latter shall be permitted to have the ownership rights in their retained profits.⁶⁸ This proposal, if implemented, would be a great progress towards guaranteeing the legal and financial interests of state enterprises. However, as explained in this chapter and in Chapter Three above, a division in the existing exclusive state ownership of the property operated by state enterprises is unlikely to be officially sanctioned in the foreseeable future.

⁶⁷ For a report, see "Woguo Gongshang Shuizhi Jiangzuo Zhongda Gaige" (The System for Industrial and Commercial Taxation in China Will Experience Important Changes), RMRB (Overseas edn.), Oct.26, 1991, p.1.

⁶⁸ See Chen Yuan (Vice-Governor of the People's Bank of China), "Woguo Jingji de Shenceng Wenti He Xuanze" (Profound Problems and Choices of the Chinese Economy), Jingji Yanjiu (Studies in Economics, Beijing), No.4, 1991, pp.18-26, at 22.

CHAPTER SIX

LEGAL STATUS OF DIRECTORS

This chapter examines the legal status of directors (managers) in Chinese state enterprises. This discussion is divided into three parts. The first part examines the legal authority and powers of directors. The discussion seeks to show the complexity and difficulties in reforming the leadership system in state enterprises. The second part of this chapter discusses directors' duties. The discussion attempts to explain the deficiencies in existing laws and to make suggestions for the improvement of the existing law concerning the legal duties of directors. This Chapter concludes with comments on the overall treatment of directors' authority and duties in Chinese law.

I. Director's Authority: Legal and Political Dimensions

A. Introduction

In China, the legal regulation of the ruling Communist Party ("CCP" or "Party") has only been theoretically possible since the beginning of the post-Mao legal and economic reforms.¹ The 1982 Constitution, though attempting to preserve the leadership of the CCP, requires that all political parties be bound by the Constitution and law.² Such requirement can

¹ For a general introduction and survey of such developments, see Robert Heuser, The Legal Status of the Chinese Communist Party, reprinted paper, initially published in D.A. Loeber (ed.), Ruling Communist Parties and Their Status Under the Law, Dordrecht Martinus Nijhoff Publishers 1986, University of Maryland School of Law.

² Art.5 of the 1982 Constitution.

be interpreted as denoting that the CCP must also be subject to the law.³

Like many other Chinese units, state enterprises are regarded as "basic-level units" (jiceng danwei) for the purpose of establishing Party organisations. Every enterprise that has three or more regular Party members shall form a grassroots Communist Party organisation.⁴ Such an organisation may, depending on the number of its Party members, take one of three forms: "basic-level Party committee" (dang de jiceng weiyuanhui), known as "Party committee" (dangwei); "general branch committee" (zong zhibu weiyuanhui); and "branch committee" (zhibu weiyuanhui). Thus, although all the heads of the grassroots Party organisations are called shuji (secretaries), their status varies significantly. While a Party committee consists of members elected by the assembly or the congress of Party members, the general branch committee and the branch committee is elected directly by the assembly of all Party members.⁵ In the present discussion, "Party committees" shall, as usually understood, embrace "basic level Party committees", "general branch committees" and "branch committees"; and "Party secretaries" shall refer to the heads of all these three types of Party organisations.

In order to carry out its overall leadership, the Party's political and ideological control over enterprises is regarded by the Chinese leadership as very important. However, the necessary presence of grassroots Party organisations leads to the problems in defining their status in state enterprises. This problem is particularly evident due to potential clashes between enterprise directors and Party secretaries with regard to enterprise management.

It must be made clear here that a substantial majority of

³ See Heuser, supra note 1, p.3.

⁴ Art.30, the Constitution of the CCP, adopted by the Twelfth National Congress of the CCP on Sept.6, 1982, as amended by the Thirteenth National Congress of the CCP in 1989.

⁵ Ibid.

state enterprise directors are Party members because of the political qualification required for their appointment. Indeed, regardless of whether or not a director is a Party member, he or she, just like a Party secretary, must carry out policies and guidelines of the state and the Party. Thus, it is to some extent more appropriate to view the relationship between directors and Party secretaries as a mere division of labour, rather than irreconcilable contradiction. Nevertheless, as will be shown below, it is one thing to hold that directors and Party secretaries should cooperate on the ground that they are all implementing policies and guidelines of the Party and the state, but it is another to judge how the power and authority concerning enterprise management is actually to be distributed between them.⁶

B. Relationship between enterprise directors and Party secretaries: a historical review

As indicated in preceding chapters, the existence of socialist state enterprises in China can be traced back to the 1930s. The Regulations Concerning the Work of Soviet State-Owned Factories ("Regulations"),⁷ issued by the People's Committee of the Chinese Soviet Republic on April 10, 1934, granted enterprise directors supreme authority. For example, directors who were as a rule appointed by superior Soviet organs held the power to make final decisions regarding all the matters within enterprises, and also bore "absolute responsibility" towards the Soviet government.⁸ It was stipulated that within a factory management committee, which usually consisted of five to seven members from relevant

⁶ For a general account of this historical development, see G. Tidrick and Chen Jiyuan, China's Industrial Reform, Oxford 1987, pp.297-312.

⁷ See the text in Chinese, in Zhonghua Suweiai Gongheguo Fulü Wenjian Xuanbian (Selected Legal Documents of the Chinese Soviet Republic), Jiangxi People's Press 1984, pp.289-90.

⁸ Ibid, Art.1.

sections within the factory, a "three-man group" (sanrentuan) consisting of the director, a representative from the Party branch committee, and a representative from the branch committee of the trade union was to be formed to assist the director to handle the day-to-day management of the factory.⁹ The persons and foremen responsible for production departments should carry out orders from factory directors, and resolve independently all the issues of their own departments -- except for the sanction on and dismissal of workers, which had to be approved by the directors.¹⁰ Thus, directors and managers were put in a position to take full charge of state enterprises. Party organisations only played a minor role in enterprise administration.

Between 1949 and 1955, the Soviet style of "one-man-authority-and-responsibility" system (edinonachalie)¹¹ was followed in China under the name of "one-man system" (yizhangzhi).¹² On August 10, 1949, the People's Government of North-East China promulgated the Implementing Regulations Concerning Establishing the Factory Management Committee and the Workers' Representative Conference in State-Owned and Public-Owned Factories and Enterprises ("Implementing

⁹ Ibid, Art.3.

¹⁰ Ibid, Art.4.

¹¹ Established in the USSR in the 1930s, its chief aims were generally to help carry out politically centralised control and economically centralised planning. But this edinonachalie proved to be difficult to implement in practice, especially in the area of Party's supervision work and possible conflict with director's authority. For a description of this troubled system in its early stages, see David Granick, Management of Industrial Firm in the USSR, Columbia University Press 1954.

¹² For a detailed study of the one-man system in China and the subsequent changes made since mid-1950s, see Franz Schurmann, Ideology and Organisation in Communist China, University of California Press 1966, especially Chapter Four: "Management", pp.220-308.

Regulations").¹³ These were later recommended by the Central People's Government as a model to be applied to enterprises across the country.¹⁴

According to the Implementing Regulations, every state enterprise was to organise a factory management committee consisting of the director (manager), deputy directors (deputy managers), chief engineer (or main engineer), other persons responsible for production, as well as an equal number of representatives from workers and staff.¹⁵ The management committee was authorised to "discuss and decide" important management issues, including production plans, business management, personnel, wages and welfare.¹⁶ A director was empowered to halt the implementation of any resolution adopted by the management committee, if he believed that such a resolution conflicted with the interests of the factory, provided that he should report to superior authorities for instruction.¹⁷ Should emergent problems arise, a director could make his own decisions, though he should report to the management committee for subsequent confirmation.¹⁸

Since these Implementing Regulations were mainly concerned with the so-called "democratic management" in state enterprises,¹⁹ the powers of enterprise directors were not clearly defined. Nevertheless, under the one-man system, compared to Party secretaries, directors were given more powers and also more responsibilities in enterprise management. In addition to the command of enterprise

¹³ See the text in Chinese, in Selected Enterprise Laws and Regulations, pp.11-5.

¹⁴ See ibid, pp.10-11.

¹⁵ Art.2.

¹⁶ Art.7.

¹⁷ Art.8.

¹⁸ Art.10.

¹⁹ Art.1. For a discussion on this "democratic management", see Chapter Seven of the thesis.

production, directors held the power to decide personnel issues, such as the selection, training, reward and punishment of staff and workers.⁴⁰ Although enterprise directors were asked to rely on the working masses, enterprise Party organisations were put in a minor position and were responsible only for enterprises' political and ideological work. Their main tasks were vaguely defined as supervising and guaranteeing the implementation in enterprises of guidelines and policies of the Party and the state. In effect, they were kept away from both decision-making and routine operation of enterprises.

In the early 1950s, the one-man system was promoted as a necessary means for implementing the centralised economic planning system. Directors, having taken charge of enterprises, were able to carry out instructions and targets prescribed by relevant superior Ministries and local governments. Nonetheless, the one-man system was not effectively applied to state enterprises across the country. Some evidence suggests that in the early 1950s, factories in Eastern China, including Shanghai, implemented the system of plant manager responsibility under the collective leadership of the Party Committee.⁴¹ The main excuse for such regional variation was the shortage of qualified technical personnel who could take up the post of directors and assume absolute responsibility for decision-making. Moreover, although the one-man system was soon afterwards ordered by the central authorities to be implemented in all state enterprises, reservation and resentment regarding this radical system were common in many areas, especially in inland areas.⁴² In addition to some objective reasons such as the large absence of technologically capable personnel to act as directors, the one-man system was criticised for ignoring both ideological and political work and democratic management in enterprises.

⁴⁰ Supra note 12, pp.253-62.

⁴¹ Ibid, p.263.

⁴² Ibid, pp.263-67.

As early as 1954, the one-man system came under intense criticism, and from 1955, it was in decline. The movement to strengthen the central leadership indicated that political incentives were also involved. In particular, the political campaign against "localism" contributed to the attack on the one-man system.²³

The Eighth National Party Congress held in September 1956 officially brought an end to the one-man system and replaced it with "the system of factory manager (director) responsibility under the leadership of the Party Committee in enterprises" (dangwei lingdao xia de changzhang fuzezhi). The old one-man system was dismissed as producing bureaucratism and subjectivism,²⁴ since it allegedly not only neglected the collective leadership of the Party, but also ignored the "enthusiasm" of the working masses.

The newly-introduced system laid great stress on collective leadership. Although managers were still held responsible for enterprise operation, all important management decisions were to be taken by Party committees. Theoretically, a distinction between policy matters and technical issues was made first. While policy matters were to be decided by Party committees, purely technical matters should be commanded by managers. But in the atmosphere of strengthening collective Party leadership, such a distinction made little practical sense. In many cases, managers were too frightened to make their own decisions. They would rather choose to put forward trifle things for Party committees to decide.²⁵ Although directors in some enterprises might sit as deputy secretaries in Party committees, it was Party secretaries, together with other Party committee members, who played a decisive role in the administration of enterprises.

²³ This campaign was especially aimed at Gao Gang, who was in charge of North-East China where the one-man system was most thoroughly implemented.

²⁴ Supra note 12, pp.284-87.

²⁵ Ibid, pp.287-93.

Despite the significant erosion of directors' authority, for several years after the introduction of the new system, at least nominally, they still held certain authority towards enterprise operation. But during the Great Leap Forward (1958-1960), Party committees took over not only policy decision-making but also the operational control of enterprises. With managers being put aside, workers were mobilized to assume a growing role in enterprise management. The practice of so-called "Two-Participations, One Reform and Three Integrations" (liangcan yigai sanjiehe)²⁶ stressed, inter alia, both cadres' participation in manual labour and workers' participation in enterprise management. The division of labour between managers and workers was made obscure, not to mention the authority of managerial personnel.

With the passing of the Great Leap Forward in 1960, enterprise managers seemed to regain certain "independent operational authority".²⁷ On September 16, 1961, the Central Committee of the CCP issued Regulations Concerning the Work of State Industrial Enterprises (Draft),²⁸ which declared enterprise Party organisations to be the "leading core" of enterprise operation.²⁹ Enterprises were to practise the system of director's administrative and operational responsibility under the leadership of the Party committee;³⁰ this Party committee was to exercise overall and unified leadership over, inter alia, administrative and operational,

²⁶ "One Reform" referred to reform of irrational rules and regulations; "Three Integrations" referred to the integration of management cadres, technicians and workers. Obviously, these slogans were aimed at mobilizing the working mass to fight against expert and managerial personnel.

²⁷ See Ideology and Organisation in Communist China, supra note 12, pp.297-307.

²⁸ See the text in Chinese, in Selected Enterprise Laws and Regulations, pp.45-72.

²⁹ Ibid, Art.6.

³⁰ Ibid.

and ideological and political work within enterprises.³¹ The coverage of important issues which were to be discussed and decided by the Party committee included: annual, seasonal, and monthly plans, and main measures to implement these plans, wage and welfare issues, and personnel.³² Thus, although directors nominally held administrative and operational powers, their powers were restrained by Party committees which acted as the real source of authority within enterprises.

In 1966, China witnessed the beginning of the Cultural Revolution which lasted for ten years and brought tremendous damage to the Chinese economy, including the organisational structure of enterprises. It is very difficult to give an accurate account of the situation throughout the Cultural Revolution, as the actual picture differed in terms of time, region and indeed individual enterprise. To summarize, enterprises were politically motivated rather than economically orientated; the popular mass movement enabled revolutionary workers to ignore the managerial functions of directors, and even the leadership of the Party committee. For example, from the late 1960s until early 1970s, the Beijing General Knitwear Factory experienced three kinds of mass organisations -- workers' management teams, the Red Guards, and Revolutionary Committee.³³ Although each type of organisation had a different composition and played a different role, all of them provided workers with direct access to manage the factory. However, beginning in the mid-1970s, the Revolutionary Committee and workers' management team were gradually dismantled and then finally disappeared.³⁴

³¹ Ibid.

³² Ibid, Art.55.

³³ See Charles Bettelheim, (translated from French by Alfred Ehrenfeld) Cultural Revolution and Industrial Organisation in China, Monthly Review Press (New York and London) 1972, pp.21-43.

³⁴ See Martin Locket, Cultural Revolution and Industrial Organisation in a Chinese Enterprise: the Beijing General Knitwear Mill 1966-1981, Management Research Paper, the Oxford

It is even more interesting to see that in that Beijing factory, during the period between 1966 and 1969, the Party committee was completely put aside and kept away from management. As a result, the mass participation and the leadership of the working class in enterprises during the Cultural Revolution disrupted production order and brought disastrous results to the operation of enterprises.

The above brief review shows that for many years prior to economic reforms the leadership systems in Chinese state enterprises were a very sensitive issue continually undergoing reversals. The main difficulty underlying enterprise leadership systems was the mechanism for the allocation of powers and authority between directors and Party secretaries. This allocation of powers reflected the uneasy marriage of economic goals to the Party's political and ideological control over state enterprises. Although workers' participation was stressed from time to time, the power struggle within state enterprises mainly developed between the directors on the one side and Party committees and their secretaries on the other. Frequent policy changes illustrated that it was difficult to achieve and maintain a proper balance between directors and Party secretaries in enterprises.

It should also be noted that, before the economic reforms, except for occasional provisional regulations and administrative orders, the issue of enterprise leadership systems were not really governed by law. The relationship between directors and Party secretaries was essentially a political rather than a legal subject. The inactivity of law provided great flexibility for changes to occur.

C. Director responsibility system Under the SEL

1. Reforms and change of enterprise leadership system

In the late 1970s, China began to experiment with state enterprise reform. As a first step towards establishing

operational order in enterprises, the system of director responsibility under the leadership of the Party Committee which was once practised before the Cultural Revolution was restored and applied to state enterprises.

The reforms soon brought to light many fateful shortcomings of the old system of director responsibility under the leadership of the Party committee.³⁵ First, under the old system, every important management matter, whether political or economic, had to be decided by the Party Committee. Such procedural requirement was bound to cause inefficiency in enterprise management and operation. Secondly, since a large number of Party secretaries had been promoted as professional political and ideological cadres, they might be unfamiliar with management. Decision-making by laymen could bring about serious losses. And thirdly, collective leadership did not help establish management responsibility. On the contrary, collective leadership actually enabled enterprise leaders, including both Party secretaries and directors, to escape from liability arising from wrong and careless decisions. As a rule, collective leadership means little responsibility for individuals.

It was soon recognised that the only way to invigorate enterprises was to give enterprises relative independence and their directors full authority while at the same time be fully responsible for losses that their enterprises sustained. For example, the contracting system by which enterprises promised to fulfil certain targets would have been impossible if directors had not possessed real power and authority.³⁶

As a result, in 1984, "the director responsibility

³⁵ For an early discussion, see Jiang Yiwei, "Lun Shehuizhuyi Qiye de Lingdao Zhidu" (On the Leadership System of Socialist Enterprises", Hongqi (Red Flag), No.21, 1980, pp.9-13 and p.19.

³⁶ For a general background, see Beijing Review, Vol.29, 1986: "Enterprises Demands More Powers", No.24, p.6; "More Power to Factory Directors", No.37, p.26; "In the Wake of Director's New Power", No.32, p.17. For a legal analysis of the contracting system, see Chapter Nine of the thesis.

system" (changzhang fuzezhi) was introduced at pilot factories in selected industrial cities including Beijing, Tianjin and Shenyang. Meanwhile, rapid progress was made to pave the way for the implementation of the director responsibility system.³⁷ Most significantly, in economic areas, separation of ownership from management was widely accepted. And in the political realm, the separation of the Party from managerial functions was at least theoretically given credit.

On January 2, 1982, the Central Committee of the CCP and the State Council jointly issued Provisional Regulations Concerning the Work of the Directors in State Enterprises.³⁸ These Regulations provided that factories should implement the system of director responsibility under the leadership of the Party committee.³⁹ Directors should "conscientiously" (zijue de) accept and preserve the leadership of the Party committees, and should regularly report their work to the Party committees.⁴⁰ The issues which should be discussed and decided by Party committees, or deliberated by Party committees and then reported to the superior authorities for approval included: policy decisions, long term plans, annual plans, important technological innovation plans, organisational changes, important personnel matters and some other issues.

To some extent, the revived system of director responsibility under the leadership of the Party committee differed from the same system practised in the late 1950s and early 1960s. First, as shown above, the coverage of issues

³⁷ See Beijing Review, "Economic Theory: Changes in Ownership Forms: Problems and Possibilities", Vol.29, 1986, No.19, p.17; "Breakthroughs in Traditional Economic Theory", Vol.30, 1987, No.36, p.15; "Reform Needs New Theories", Vol.31, 1988, No.49, p.6.

³⁸ See the text in Chinese, in Bulletin of the State Council, No.2, 1982, pp.36-40.

³⁹ Ibid, Art.2.

⁴⁰ Ibid, Art.10.

controlled by the Party committee was reduced. Secondly, it was expressly provided that issues which were not clearly listed under the control of Party committees should be decided by the directors.⁴¹ Thirdly, for those issues controlled by the Party committee, if a director did not agree with decisions made by the Party committee, he could challenge the decisions.⁴²

This relaxation of Party committees' control over enterprise management reflected certain progress towards promoting director's authority in the reforms. On April 1, 1983, the State Council promulgated Provisional Regulations Concerning State Industrial Enterprises.⁴³ Although it was reiterated that the system of director responsibility under the leadership of the Party committee should be practised in state enterprises,⁴⁴ directors were nevertheless declared to be the persons responsible for the administration of enterprises and should exercise unified command over enterprise production and administration.⁴⁵ However, no further attempt was made to clarify the respective authority of directors and Party committees.

The gradual growth of directors' authority finally made a breakthrough. On September 15, 1986, the Central Committee of the CCP and the State Council jointly issued three sets of "Working Regulations"⁴⁶ concerning directors, grassroots Party

⁴¹ Ibid, Art.2.

⁴² Ibid, Art.10. The director could first ask the Party committee for reconsideration. If he still disagreed with the result of the reconsideration, he could report the issue to the superior authority which should render a judgement promptly.

⁴³ See the text in Chinese, in Laws and Regulations of the PRC (1983), pp.383-99.

⁴⁴ Ibid, Art.4.

⁴⁵ Ibid, Art.8.

⁴⁶ See the text in Chinese, Bulletin of the State Council, No.1, 1987, pp.3-21. Also see an English translation in Statutes And Regulations of the People's Republic of China,

organizations and workers/staff's congress respectively. These regulations were promulgated as guidance for the implementation of the director responsibility system. Most significantly, Party committees were confined to exercise ideological and political leadership which was defined in principle as guaranteeing and supervising the implementation in enterprises of various Party and state guidelines and policies.⁴⁷ Theoretically, except those conflicting with the provisions of the SEL and new Party policies, most provisions of these three sets of regulations remain effective until today. Some of them will be referred to in later discussion.

By 1986, the orientation of state enterprise reform had become clear. In particular, it was settled that state enterprises should be vested with the right of management.⁴⁸ Subsequently, the drafting of the SEL was soon in full swing.

One problem, however, remained difficult to address. Most previous documents concerning enterprise leadership structures were promulgated by the CCP or jointly by the CCP and the State Council, and were therefore informal in nature. As the SEL was prepared as the formal law of the state, how should it deal with enterprise Party organisations? In other words, should the law make stipulations concerning the legal status of Party organisations? And, if so, in what way should the law make these stipulations?

As to the first question, early drafts of the SEL did not mention Party organisations,⁴⁹ perhaps leaving it to be dealt with exclusively by the Party Constitution.⁵⁰ However, the

Vol III, UEA Press (Hong Kong).

⁴⁷ "Regulations Concerning the Work of Grassroots Party Organisations in State Enterprises", ibid, Art.3.

⁴⁸ For an explanation, see Chapter Three of the thesis.

⁴⁹ See Yuan Baohua, "Jiu Quanmin Suoyouzhi Gongye Qiyefa Zuo Shuoming" (Explanations Concerning the Draft Law on State Industrial Enterprises), RMRB, Nov.16, 1986, p.1.

⁵⁰ This, for example, was the practice in the Soviet Union where the status of Party organisations was not provided in the State Enterprise Law, but in the Party's Constitution. See

draft SEL which was published in January 1988 for national solicitation contained a provision about Party committees' role of "supervision and guarantee".⁵¹ This draft provision soon attracted open criticism.⁵²

To some extent, critics of this provision attempted to distinguish the law of the state from the Constitution of the Party. They insisted that it was improper for formal laws to make stipulations on Party committees as political organisations.⁵³ Moreover, they argued, if the law did provide for the function of Party organisations, it would be difficult to define and enforce the legal liability for Party organisations which failed to perform their function of "supervision and guarantee".⁵⁴ In addition, in the view of critics, if the law did unconditionally provide for the role of Party committees, it would be ridiculous if a small enterprise which did not have a Party committee because of the shortage of Party members would have to establish a Party organisation by recruiting Party members from the outside.⁵⁵

Whatever the causes and implications of these challenges were, the Chinese central leadership was determined to use the law to reflect the role of Party committees in state

Wang Baoshu, "Shilun Gaige Zhongde Sulian Dongou Guojia Guoying Qiyefa" (On the State Enterprise Laws in the Soviet Union and Eastern Europe in the Era of Reforms), FXPL, No.5, 1988, pp.78-83.

⁵¹ Art.7. For the text of this draft, see RMRB, Jan.12, 1988, p.2.

⁵² See for example Professor Xie Huaishi, "Qiyefa Mouxie Tiaowen Zhi Wojian" (My Opinions Concerning Several Articles of the Draft SEL), in GMRB, Feb.4, 1988, p.3.

⁵³ Ibid. They argued that the status of the Communist Party was not provided in the text of the 1982 Constitution (although it appeared in the Preamble of the Constitution). Moreover, some important laws such as the Organisational Law of the State Council did not include Provisions as to the leading role of the Communist Party, but such absence had not affected the leadership of the Party.

⁵⁴ Ibid.

⁵⁵ Ibid.

enterprises. On April 13, 1988, the SEL was adopted. The SEL confirmed the director responsibility system, but retained the provision concerning enterprise Party committees. As a result of this provision, the director-Party secretary relationship has become a legal issue in addition to a political and historical phenomenon.

2. "Central" position of enterprise directors

The SEL declared that enterprises should implement the director (manager) responsibility system.⁵⁶ Factory directors should exercise their powers according to law and should be protected by law.⁵⁷ Moreover, enterprises were to establish a system for the management of production and operation, which were headed by directors.⁵⁸ Directors were to occupy the "central position" in enterprise management and to be fully responsible for the construction of material wealth and morale of enterprises.⁵⁹ In 1988, these provisions reflected a magnificent achievement of economic reforms, since they expressly declared that it was the director, not the Party secretary, who was to be the "centre" within an enterprise.

The SEL authorised directors to command the management of production and operation of enterprises, and to exercise a number of powers.⁶⁰ These powers included:

- a. deciding on or submitting for approval various plans of the enterprise in accordance with the law and State Council regulations;
- b. deciding on the establishment of the administrative structure of the enterprise;
- c. submitting to competent government departments requests for appointing and removing or engaging and dismissing leading administrative cadres at the level of deputy factory directors, with the exception of those for whom the law and State Council stipulations provide

⁵⁶ Art.7.

⁵⁷ Ibid.

⁵⁸ Art.45.

⁵⁹ Ibid.

⁶⁰ Ibid.

otherwise;

d. appointing and removing or engaging and dismissing administrative cadres at the intermediate level, with the exception of those for which the law provides otherwise;

e. submitting wage adjustment plans, bonus distribution plans and important rules and regulations to workers' congress for approval and submitting to worker -- staff congress for approval plans for the application of welfare funds and proposals concerning other major issues in respect of the welfare of workers;

f. awarding and punishing workers according to the law, submitting to the competent government departments requests for rewarding or punishing leading administrative cadres at the level of deputy factory director.

What is somewhat puzzling, however, is directors' responsibility in the aspect of morale construction. In the Chinese context, "morale" (jingshen wenming, or "spiritual civilisation") is similar to the so-called political and ideological work which used to be charged by Party committees. This morale work is not directly relevant to the economic operation of enterprises, but it is very important for the realisation of the political pursuits of socialist enterprises. Moreover, in the mid-1980s, for directors who attempted to occupy a "central" position in enterprise management, the responsibility for enterprises' morale work was necessary. The underlying reason is that the assumption of this responsibility would not only enable directors to take effective command of enterprises, but also put them in a superior position than Party secretaries.⁶¹

3. Minor role of Party organisations

The SEL provided that enterprise Party committees shall guarantee and supervise the implementation in enterprises of

⁶¹ In the early days of reform, there existed a system called "fengong fuzezhi" (division of responsibilities), with directors responsible for administrative direction, and Party secretaries for political and ideological work. It was nevertheless later seen as an obstacle to the full director responsibility system. For a basic description of this situation, see Heath B. Chamberlain, "Party Management Relations in Chinese Industries: Some Political Dimensions of Economic Reform", China Quarterly, December 1987, No.112, pp.631-61, especially pp.639-44.

guidelines and policies of the Party and the state.⁶² Notwithstanding the considerable confusion over the term of "supervision and guarantee" displayed during previous years,⁶³ the SEL failed to clarify the meaning and contents of, and the ways for realising, such "guarantee and supervision". This treatment appeared to be a compromise between no legal provision at all and too many legal provisions, concerning Party committees.⁶⁴ However, such ambiguous treatment would seem to bring chaos and confusion to the operation of the new enterprise leadership system. Given the traditional "leading core" position⁶⁵ of the Party committees in enterprise management, if the roles of Party committees had been left unclear, the unilateral authorization with enterprise directors of the "central" position would have been difficult to understand and implement properly.

The Chinese leadership clearly realised this shortcoming. In order to rescue the situation, on April 28, 1988, the Central Committee of the CCP issued a Circular⁶⁶ which dealt in detail with the role and function of Party organisations. In addition, many provisions of the above mentioned Regulations Concerning the Work of Grassroots Party Organisations in State Enterprises ("Party Regulations")⁶⁷ are very useful for reference purposes.

⁶² Art.8.

⁶³ For a description of such confusion, see Chamberlain, supra note 61, pp.651-54.

⁶⁴ See "Jiang Ping Jiaoshou Tan Qiyefa Caoan" (Professor Jiang Ping on the Draft SEL), RMRB, Apr.6, 1988, p.2. Professor Jiang suggested that the SEL should concentrate on the operation and management as the main activities of enterprises, and detailed regulations concerning the Party committees should be left for the Constitution of the Party to provide.

⁶⁵ This position was first formally confirmed in the Regulations Concerning the Work of State Industrial Enterprises (Draft) (1961). See supra note 28.

⁶⁶ See the text in RMRB, May 9, 1988, p.1.

⁶⁷ Supra note 46.

The Party Regulations listed the following as the main contents of "guarantee and supervision":

- a. the socialist direction of enterprises' operation and management;
- b. the overall enjoyment of democratic rights by the staff and workers of the enterprise;
- c. the correct treatment of the relation of interests among the state, the enterprise and the staff and workers;
- d. observance of discipline and law by the enterprise, and protection of the legal interests of the state and the enterprise;
- e. the correct implementation of the guidelines and policies of the Party by the enterprise and the director.⁶⁸

The Party Regulations also continued to lay down the main ways for the realisation of such guarantee and supervision:

- a. Organising Party members and cadres of the enterprises to conscientiously study the guidelines, policies, laws and regulations of the Party and the State, and bringing into full play the exemplary vanguard role of the Communists;
- b. listening regularly to the work report of the directors, and providing opinions and suggestions;
- c. strengthening the work of inspecting discipline;
- d. amplifying the regular activity of the Party organisations, and carrying out criticism and self-criticism;
- e. supervising cadres in many ways.⁶⁹

Just as many of these provisions tended to be very vague and politicised, the Circular took a similar approach. It required that enterprise Party organisations mainly pay attention to Party construction, bring into full play the roles of both "fighting fortress" (zhandou baolei) and "vanguard" (xianfengdui) of Party members, carry out ideological and political work, support directors to fully exercise their powers in accordance with the SEL, and provide opinions and suggestions concerning important issues.⁷⁰

⁶⁸ Ibid. Art.16.

⁶⁹ Ibid., Art.17.

⁷⁰ Supra note 66. It is interesting to see that the Draft SEL did contain provisions requiring Party committees to support directors in exercising their powers in accordance with the law. But this provision was later dropped in the approved SEL and instead, came out in the Party Circular.

Consequently, the role of Party committees was substantially restricted to political and ideological spheres.

The SEL simply put Party secretaries in a position to assist directors. As for enterprise management, a Party secretary might only sit in the enterprise committee to help the director make important decisions.⁷¹ Even in the political field, because of the "full responsibility" of directors, Party secretaries had to confine their work to Party committees and Party members only. The Circular particularly instructed that, because the Party was not a "power organ" (quanli jigou), it should perform its work through "persuasion, illustration and attraction".⁷²

In a further attempt to reduce the role of Party organisations, the Circular ordered a cut in the number of professional Party and political workers in enterprises.⁷³ Professional personnel and working bodies of Party committees should be "fewer in the number of people but better in their quality" (shao er jing). Moreover, while large enterprises could set up full-time secretaries, deputy secretaries, and professional bodies which were small in number but highly

⁷¹ Art.47, SEL. This article, which merely employed the term "persons in charge of various functions of enterprise", implied that Party secretaries might participate in the enterprise management committees. Here "important issues" were limited to those regarding business policies, long term and annual plans, capital construction plans, plans for major technical reforms, training programmes for workers, wage adjustment plans, plans for distributing and applying retained funds and plans in respect of the management responsibility system, staffing and organisational matters, etc. The proposals for these matters should be presented by the director who should also make final decisions.

⁷² Supra note 66.

⁷³ There is evidence to show that in isolated experiments approved and guided by some local Party committees, enterprise Party organisations were abolished and, instead Party committees were reorganised at the local and street level to take up the political and ideological works which used to be done by Party organisations within enterprises affected by the reform. For the information, see Zhang Zhanbing, Xin Zhongguo Qiye Lingdao Zhidu (Enterprise Leadership Systems in New China), Spring and Autumn Press (Beijing) 1988, pp.262-63.

trained, small enterprises should in principle only have part-time Party personnel. Whether or not medium-sized enterprises should have full-time personnel and working bodies was a choice to be made by enterprises concerned. In addition, the Circular pointed out that a large number of professional Party personnel should be transferred to engage in production, technological, management and operational work. The Circular even ordered that members and secretaries of enterprises Party committees should be elected from more candidates.

Thus, despite the fact that the SEL itself did not clarify the roles and functions of Party organisations, relevant policy documents had made it fairly clear that Party organisations should be restricted to play a minor role in enterprise management.

4. Practice before June 1989

During the transitional period from the system of director responsibility under the leadership of the Party committee to the director responsibility system, considerable confusion and uncertainty remained. Generally speaking, four types of relationships between directors and Party secretaries were reported to be present.⁷⁴ The most ideal was tacit cooperation in which directors and especially Party secretaries behaved in the same way as the Working Rules and the SEL required them to. A second type of relationship was that Party secretaries remained passive. They played a minor role and did very little. This was basically in line with the reform, but could be criticised by the leadership since Party secretaries even failed to perform their functions of "guarantee and supervision". In the third kind, Party secretaries "held court from behind a screen" (chuilian tingzheng). This could happen when, for example, directors were significantly junior, in age or/and in political

⁷⁴ See the report by Xie Haoran, "Mingque Mubiao, Zhuanbian Guannian -- Shanghai Shixing Changzhang (Jingli) Fuzezhi Caifang Zhaji" (Clarifying Aims and Changing Ideas -- Notes on the Implementation in Shanghai of the Director (Manager) Responsibility System), JJRB, Sept.27, 1986, p.2.

experience, to Party secretaries. The transition of the power centre from Party secretaries to directors had clearly made many Party secretaries unhappy. In order to save their face, they sought to regain control over enterprises by making difficulties for directors.

The fourth type of relationship reflected the extreme attitudes taken by both directors and Party secretaries towards the establishment of the new system. That was the collision between the "two bigs". Despite the SEL provisions, some Party secretaries continued to see themselves as the "centre" of enterprise management. The People's Daily reported⁷⁵ that in one factory in Henan Province, Party secretaries disagreed with the director's decision to dismiss a deputy director and neither side wanted to compromise. Then the Party Committee decided to annul the status of the director as a probationary Party member.⁷⁶ Soon after, the director responded radically by taking a series of administrative actions, including dismissing the Party secretary from the factory. Obviously, both sides were criticised by the official paper on the grounds that they had used their powers "improperly" and brought serious losses to the factory by declaring "civil war" against each other.

It is impossible to tell the exact proportion for each of the above described four types of situations. Discontent from both directors and Party secretaries was frequently reported in the Chinese press. Directors complained that they did not have sufficient authority to make and subsequently carry out their decisions while Party secretaries grumbled that they had been completely despised by enterprises and workers.⁷⁷ The significant reduction of the powers for Party secretaries meant the immediate collapse of their authority within

⁷⁵ See RMRB, May 21, 1988, p.1.

⁷⁶ Such status could be very important for a director who wanted to be promoted in the future.

⁷⁷ In the Chinese term, this was called shiluogan (feeling of losing or alienation).

enterprises. Even their function of "guarantee and supervision" could survive only nominally. The dominant Party policy at that time clearly and strongly favoured the radical implementation of directors' authority; any complaint from Party secretaries against directors was likely to be labelled as either contradicting Party lines or the SEL which had reflected Party's policy. Nevertheless, popular discontent among Party and political personnel remained. And finally the mass protest which resulted in the "Tiananmen Event" in June 1989 provided an opportunity for these frustrations to erupt.

D. Director responsibility system after June 1989

1. Policy changes since June 1989

The events of June 1989 immediately reminded the Chinese leadership of the great importance of upholding the Party's leading role, especially in grassroots organisations. As far as state enterprises were concerned, the director responsibility system soon came under severe attack. The practice that enterprise Party organisations were simply put at a subordinate position to assist directors could no longer be tolerated.⁷⁸

In order to strengthen the leadership of the Party, a series of measures were taken. Only two months after June 1989, grass root Party organisations were urged and authorised to take up more work and to occupy the position of "political

⁷⁸ There are also many conceptual as well as theoretical disagreements over the former Party General Secretary Zhao Ziyang's policy. See especially Fan Ping, "Shixing Dangzheng Fenkai Yu Jianchi He Jiaqiang Dang de Lingdao" (Implementing the Separation of the Party From Managerial Functions and Upholding and Strengthening the leadership of the Party), BJRB, Nov.11, 1989, p.3. One aspect is that the reform of the political structure is "to separate the Party from managerial functions, not to break up the Party and the administration" (shixing dangzheng fenkai, bushi dangzheng fenjia). Another aspect is that "the Party must discipline its members, but its function is not limited to only this" (dang yao quandang, dan bushi dang zhi quandang). In other words, Party committees must participate in the important decision-making of enterprises.

core".⁷⁹ But this move immediately caused considerable confusion since it became controversial who, directors or Party secretaries, should be more important and more central in enterprise management.⁸⁰ In order to "clarify" the confusion among cadres and the people, on December 24, 1989, the Organisation Department of the Central Committee of the CCP attempted to explain several issues regarding the "political core" position of enterprise Party organisations.⁸¹

According to the official explanations, the "political core" position is mainly concerned with ideological and political work of enterprises, while the "central position" of directors, as provided in the SEL, should be interpreted as principally related to enterprise operation and management.⁸² Consequently, both "political core" and "central position" can be "united and unified organically" in spite of their different functions.⁸³

The reasons for restoring the political core position of

⁷⁹ The term "political core" was first raised by the Party General Secretary in an informal discussion with the heads of the Organisational Departments of the CCP across the country. For a report, see RMRB, Aug.22, 1989, p.1. The text of his speech was later published in Qiushi (Seeking the Truth, Beijing), No.20, 1989, pp.2-6. A few days later, the Politburo of the Central Committee of the CCP adopted a Circular Concerning Strengthening Party's Construction, which formally called for reinforcing the role of the grassroots Party organisations. For a report, see RMRB, Aug.29, 1989, p.1.

⁸⁰ The Chinese usually take the view that "core" (hexing) is far more important than "centre" (zhongxing). For example, it has always been the saying that the CCP is the leading "core" of China. It seems improper to replace "core" in this sentence with "centre".

⁸¹ "Jiu Qiye Dang De Gongzuo de Jige Wenti, Zhongzubu Fuzeren Da Xinhuashe Jizhe Wen" (Responsible Person From the Organisational Department of the Central Committee of the CCP Answers Several Questions Raised by the Correspondent From Xinhua News Agency and Concerning the Work of Enterprise Party Organisations, hereinafter "Answers"). See the text in Chinese, in JJRB, Dec.25, 1989, p.1.

⁸² Ibid.

⁸³ Ibid.

Party committees were stated in three aspects.⁸⁴ First, the CCP is the "vanguard" (xianfengdui) of the working class. Secondly, the CCP is the ruling Party. And thirdly, socialist enterprises are not only economic organisations, but also bear certain social administration functions. Therefore, it is an important task of enterprise Party committee to take up ideological and political work and to equip people with ideal, morale, education, and disciplines.⁸⁵

The responsibilities and tasks of the enterprise Party organisation were reinterpreted and specified in six areas:

- a. guaranteeing and supervising the implementation in the enterprise of a variety of guidelines and policies of the Party and the state, and preserving the socialist orientation of the enterprise;
- b. leading the ideological and political work and morale construction;
- c. according to the principle that the "Party should administer cadres" (dang guan ganbu), strengthening the education, training, examination and supervision of cadres, especially leading cadres, examining and recommending middle level administrative cadres, and providing opinions and suggestions concerning middle level cadres nominated by the director;
- d. exercising leadership over the worker -- staff congress, the trade union, the Communist Youth League and other mass organisations, supporting these organisations to launch their activities independently and responsibly in accordance with the law and their articles of associations;
- e. providing opinions and suggestions as to important enterprise issues, participating in the decision-making, supporting directors (managers) to exercise their powers in accordance with the law, and coordinating the relations between the directors and the worker -- staff congress and other mass organisations;
- f. improving the ideological, organisational and style construction, and bringing into full play the role of the Party organisation as the fighting fortress and the exemplary vanguard role of the CCP members.

Thus, compared to the provisions of the Party Regulations (as quoted earlier), Party organisations' role of guarantee and supervision has not only been explained in more detail but also been significantly enhanced. In order to understand the

⁸⁴ Ibid.

⁸⁵ Ibid.

major changes, it is necessary to make several comparisons between the situation before and after June 1989.

First, enterprises' political and ideological work has been partly shifted. Before June 1989, directors were held responsible for enterprises' construction in not only material but also "morale" aspects. Party secretaries were required to help and support directors in exercising their powers.⁸⁶ After June 1989, enterprises' ideological and political work has been put under the unified leadership of Party organisations. despite that directors still bear "important responsibility" for the ideological and political work and morale construction within enterprises,⁸⁷ they must support Party secretaries in this respect. Thus, directors should report promptly every season to the Party organisations and all the workers and staff the aims, tasks, situations and problems of the operation and management; they should carry out the ideological and political work in the production, operation, distribution and administration of enterprises; they should also ensure and improve the working conditions for the ideological and political work and the morale construction.⁸⁸

Moreover, in order to strengthen Party organisations' political and ideological work, the number of professional cadres engaging in this aspect has been increased. As mentioned earlier, in the mid-1980s, many such cadres were ordered to change their profession and to work on production, technology or management.⁸⁹ But after June 1989, most enterprises have been required to staff full-time political and ideological cadres.⁹⁰ In principle, the number of cadres who are engaged in the Party, ideological and political work

⁸⁶ See CCP Circular, supra note 66.

⁸⁷ See Answers, supra note 81.

⁸⁸ Ibid.

⁸⁹ See CCP Circular, supra note 66.

⁹⁰ See a report, in RMRB, Jul.21, 1989, p.1. The proportion was set between one to two per cent.

should not exceed one per cent of the total number of workers and staff in the enterprises concerned.⁹¹ But enterprises whose workers are scattered, and whose production activities are mobile may set up political personnel whose numbers exceed one per cent of their workers and staff.⁹² Large and medium-sized enterprises should set up full-time Party secretaries, deputy secretaries (in case of the directors concurrently acting as Party secretaries), and certain functional departments such as discipline and propaganda.⁹³ Within large and medium-sized enterprises, branch factories and large workshops may also set up full-time secretaries and deputy secretaries.⁹⁴ Party secretaries in small enterprises may be either full or part-time. Although small enterprises may not set up political working bodies, they must have a certain number of persons responsible for ideological and political work.⁹⁵

Secondly, Party committees have gained more access to enterprise management. Before June 1989, Party secretaries were asked not to interfere with enterprise management which should be charged by directors. They could only make suggestions and provide opinions concerning "important management issues."⁹⁶ Even for these issues, it was the directors who should make final decisions.⁹⁷ As indicated earlier, the inactive involvement of Party organisations in enterprise management directly led to the collapse of their authority. And this aspect was picked up by some commentators who argued for more positive participation by the Party

⁹¹ See Answers, supra note 81.

⁹² Ibid.

⁹³ Ibid.

⁹⁴ Ibid.

⁹⁵ Ibid.

⁹⁶ See CCP Circular, supra note 66. For a definition of "important issues", see Art.47, SEL.

⁹⁷ See Arts.45 and 47, SEL.

committee in enterprise decision-making.⁹⁸

Since June 1989, enterprise Party organisations have been expressly authorised to participate in enterprise management decision-making, including many important operations and management activities, long term development schemes, annual operation plans, important technological innovation items, distribution principles of wages and bonus, and arrangement about important work for a certain period.⁹⁹ Before making important decisions, directors "shall put proposals and plans for Party Committees to discuss, and sincerely listen to the latter's opinions."¹⁰⁰ Therefore not only has the scope of "important issues" been enlarged, but also Party organisations has been authorised to participate in management more actively.

One distinction may, however, be made.¹⁰¹ While grass root Party organisations in those units¹⁰² which apply the system of administrative head responsibility under the leadership of the Party Committee shall "make" decisions, Party organisations in enterprises shall only "participate" in the decision-making. They shall only make checks on political principles, political orientations and important lines and policies, and may not interfere with the routine administration of directors.¹⁰³

Thirdly, Party secretaries have been authorised with significant power to decide personnel issues. The SEL authorised directors with the powers to appoint and remove

⁹⁸ See Fan, supra note 78.

⁹⁹ See Li Ximin (Party secretary of Beijing Municipality), "Bixu Mingque Dang Zhuzhi de Zhengzhi Hexin Diwei" (The Political Core Position of Party Organisations Must Be Firmly Established), BJRB, Oct.12, p.1.

¹⁰⁰ Ibid.

¹⁰¹ Ibid.

¹⁰² For example, universities, city street communities, communes in rural areas.

¹⁰³ See Li, supra note 99.

deputy directors and administrative cadres at intermediate level except otherwise provided by law and regulations.¹⁰⁴ After June 1989, these powers have been nominally reserved for directors. But before any personnel appointment is made, appointees must be investigated by personnel departments of both the Party Committee and the administration. They must also be examined collectively by the Party Committee and directors.¹⁰⁵ If there is disagreement between them, the case must be reported to and then decided by a higher Party and government authority. Party organisations shall check the political and ideological quality of appointees, though they are required to respect directors' opinion in other aspects of appointees.¹⁰⁶ As a result of the necessary involvement by the Party committees, directors' personnel power has been substantially undermined.

2. Brief assessment of the present system

The above examination of the changes which have taken place since June 1989 reveals that the present system represents a different vision from the one that was meant by the SEL in 1988. Although directors are still described as occupying a "central" position, Party secretaries have been authorised to participate economically and dominate politically in the operation and management of enterprises. In fact, the present system is no less than a conciliatory retreat from the director responsibility system as practised before June 1989.

On the other hand, the current system should also be distinguished from the previous system of director responsibility under the leadership of the Party committee. Most significantly, the Party committee has not assumed overall leadership over enterprise management. In fact, the strengthening of the Party leadership over enterprises has

¹⁰⁴ Art.45.

¹⁰⁵ Ibid.

¹⁰⁶ Ibid.

been realised largely in the name of "participation, guarantee and supervision". Directors still at least nominally and "legally" occupy a "central" position in enterprise management.

3. Practice: cooperation and problems

The dramatic policy changes since June 1989 have created problems. As indicated above, considerable confusion exists as to the relative importance of the "centre" (director) and the "core" (Party secretary). The Chinese leadership is aware of the problem. It has repeatedly made the call that the director and the Party secretary should "cooperate" with each other.¹⁰⁷ It has also been emphasized that "'centre' and 'core' should be merged into 'one mind'" (liangxin bian yixin).¹⁰⁸ However, in practice, this ideal cooperation is very difficult to realise.

First, it is difficult to distinguish enterprise management from ideological and political work. The respective authority, functions, and responsibilities for directors and Party secretaries are not completely clear. For example, Party secretaries are required to participate in enterprises' important decision-making, but in case that a Party secretary disagrees with a director in management matters, the consequences are unclear. This uncertainty may cause serious problems when a proposal or business opportunity needs an urgent decision in a situation of increasing economic competition.

Secondly, some areas, notably personnel powers, are still unclear. An appointee who is a technical expert but nevertheless regarded by a Party secretary as politically inactive may lose the opportunity to be appointed and

¹⁰⁷ See Jiang's speech at the Fifth Plenary Session of the Thirteenth Party's Congress, RMRB, Nov.22, 1989, pp.1 and 4.

¹⁰⁸ See, for example, the speech delivered by Premier Li Peng in the National Planning Conference held in late 1990, Qiushi (Seeking the Truth), No.1, 1991, pp.8-17 and p.44, at 13.

promoted. This may adversely affect management and production efficiency. Likewise, one who is politically and ideologically suitable may depend heavily on personal relations and other aspects which may be not only uncertain but also irrelevant to the professional qualifications of the person concerned.

Thirdly, because of these ambiguities, it is very difficult for either the director or the Party secretary to comprehend correctly and implement properly the law and the Party policy. Theoretically, they should support each other. But in case of disagreement, compromise can be very difficult. A director who does not give in to the Party secretary may be blamed as not respecting the leadership of the Party. Similarly, a Party secretary who insists on his own opinions may also be charged as "contrary to the Party policy".

In the end, the effects in the implementation of the present system vary from enterprise to enterprise. In one enterprise,¹⁰⁹ as a first step towards cooperation, director and the Party secretary recognised that they were aiming at the "same destination". Then they sought to "respect, trust, understand, link up and support" each other. In practice, the director "never considered himself to be the centre"; he took the initiative to report important issues to the Party committee, and thus helped the Party committee realise "guarantee and supervision". As for personnel matters, the director took only the wages of cadres under his jurisdiction, thereby leaving the Party committee to examine, appraise, and review enterprise cadres. And every Saturday, the director reported important issues concerning production and management of the previous week to the joint meeting of the Party committee, the administration, and the mass organisations. Before making final decisions concerning important issues, the director widely consulted opinions from others, including the Party committee. On the other hand, as a concession, the Party

¹⁰⁹ See Xia Chuandi and Zhou Yanxue, " 'Zhongxin' 'Hexin' Yi Tiaoxin, 'Zhuren' 'Puren' Yi Jiaren" ('Centre' and 'Core' Are One mind, 'Master' and 'Servant' Are Within One Family), in Jingji Tizhi Gaige (Economic System Reform, Sichuan), No.2, 1991, pp.97-101.

committee did not present itself as the "core". Rather, it supported the central position of the director by emphasizing that the main task for the enterprise was to improve economic efficiency. Therefore, in the area of management and production, the Party committee sought to act as a good advisor to the director. In order to strengthen ideological and political work, both the director and the Party committee agreed to take various measures. For example, the number of ideological and political cadres was secured and they were also given the opportunity to obtain professional titles and enjoy the same treatment in their incomes and other aspects as staff engaging in management and production. The Party secretary did not have any administrative position and therefore was able to "dedicate himself to ideological and political work."

In another enterprise,¹¹⁰ the "central position" of directors has been deliberately played down. The term "director" (changzhang) was understood to be a "collective concept" (gunti gainian) which referred not only to the manager, but also to the Party committee and even the workers'/staff's congress. Therefore, before decisions were taken, the director always obtained the majority consent among cadres within the enterprise.

Of course, these are just model cases. Cooperation between directors and Party committees was based on the modest declination of both sides and the mutual "respect" between them. It may therefore be the case that neither the director nor the Party secretary was able to make resolute decisions on his own. This situation contrasts with the radical policy in 1988 when the SEL was adopted.

In practice, the implementation of the present system is far from satisfactory. The overall practice can be described

¹¹⁰ See Chen Qingtai and Ma Yue, "Jianchi 'Chuche Yuren', Zengqiang Qiye Huoli" (Adhering to 'Educating Workers While Making Vehicles', Increasing the Vitality of Enterprises), GRRB, Mar.13, 1992, pp.1 and 2. This was a report written by the director and the Party secretary of the No.2 Vehicles-Making Factory in Hubei Province.

as fairly bleak. For example, a survey conducted by the All China Federation of Trade Unions concluded that the present system was "difficult to be operated in practice".¹¹¹ Of all Party committees in the surveyed enterprises, only forty-five per cent were praised as being able to effectively play the role of guarantee and supervision.¹¹² According to an official report,¹¹³ an analysis based on 27,000 state enterprises across the country revealed that in 40.2 per cent of these enterprises, directors and the Party committees had "smooth cooperation"; in 49.4 per cent of these enterprises, such cooperation was just "on the way"; but in 10.4 per cent of these enterprises, the relationship between the directors and the Party committees was "not satisfactory" due to the existence of "many contradictions".

In addition to the uncertainties cited earlier, one problem deals particularly with the confusion over the proper way to resolve conflicts between directors and Party secretaries. This is because both directors and Party secretaries tend to report problems to their own superior authorities.¹¹⁴ Directors usually seek help from government departments in charge of their enterprises, whereas Party secretaries would normally obtain the opinions from their superior Party committees. In the end, problems become more complicated, and contradictions remained unresolved.

E. Law versus policy: some aspects

It is interesting to observe the way that the law copes with new situations resulting from drastic policy changes. In China, law has been widely recognised as the reflection of

¹¹¹ See "Guanyu Qiye Fa Guance Luoshi Qingkuang de Diaocha Baogao" (A Survey Report on the Implementation of the SEL), in JJGL, No.10, 1990, pp.24-7, at 26.

¹¹² Ibid.

¹¹³ RMRB (Overseas edn.), Jun.6, 1991, p.1.

¹¹⁴ Supra note 111, p.26.

Party policies.¹¹⁵ This judgment appears to imply that law should be amended in order to keep in line with new and changed Party policies. Indeed, the above mentioned survey found that the present policies are "incompatible with the provisions of the SEL", and further suggested that the SEL should be revised to make clearer and detailed stipulations concerning the role of Party committees.¹¹⁶

Immediately after June 1989, one problem addressed to the Chinese leadership was whether the SEL should be amended to fit the new political climate. In view of the dramatic changes, an amendment of the SEL seemed necessary. Nevertheless, not long after June 1989, some Chinese officials began to down play speculation regarding the amendment of the SEL by emphasizing that the director responsibility system would continue. Interestingly, in Chinese official view, one of the reasons for not changing this system was singled out to be that this system had been enacted in the SEL adopted by the NPC and the "seriousness" (yansuxing) of the law should be respected.¹¹⁷

It would, however, be unrealistic to believe that the respect for law was the most important reason for not amending the SEL. In my view, the fundamental reasons for maintaining the SEL are more profound than the mere confidence in, and the alleged highest authority of, the SEL. First, the director responsibility system is necessary since it is a basis for the contracting system which has been practised in more than ninety per cent of large and medium-sized state

¹¹⁵ See Robert Heuser, supra note 1, especially pp.1-3. Also see Henry Zheng, China's Civil and Commercial Law, Butterworths, 1987, pp.9-10.

¹¹⁶ Supra note 111, pp.26 and 27.

¹¹⁷ See for example Premier Li Peng, "Sizhong Quanhui Qian Gaige Kaifang Chuoshi" "Yao Jixu Zhixing" (Measures of Reform and Open Door Decided Before the Fourth Plenary Session of the Thirteenth Party Congress Must Continue To be Implemented), RMRB (Overseas edn.), Sept.2, 1989, p.1.

enterprises.¹¹⁸ It would be impossible to carry out the contracting system if the director responsibility system would be abandoned.

Secondly, it is to some extent possible for the SEL to bear, without any change in the written law, the political changes since June 1989. The underlying reason is that the SEL, like many other Chinese laws, was enacted in a way which is so flexible and so vague that it could remain unchanged despite vast social, economic and political changes. For example, as mentioned earlier, the SEL does not provide the meanings of, and the ways for, the "supervision and guarantee" of the Party committee. Such loose provisions can be understood and implemented in a variety of ways adaptable to different situations. Thus, "supervision and guarantee" can be carried out either actively or passively, depending on the Party policies of the time and individual cases. Similarly, Party organisations' participation in management decision-making can either be labelled as "interfering with directors" or be interpreted as faithfully exercising the function of "supervision and guarantee". In this way, the written provisions of the SEL can survive dramatic policy changes. Furthermore, as the SEL makes clear, "supervision and guarantee" are aimed at the implementation of "the guidelines and policies of the Party and the state". It follows that if Party policies change, the contents of, and the ways for, "supervision and guarantee" should also be changed. Indeed, the role of enterprise Party organisations, like that of directors, is provided in the "General Provisions" of the SEL, such provisions have the authority to override other more detailed provisions of this Law. Accordingly, because of mouldable legal provisions, the changes in Party policies are not necessarily followed by changes in the legal provisions. Rather, it is the interpretation of the law which varies.

Another way of getting around formal legal provisions is to take advantage of the "exception" provisions. For example,

¹¹⁸ For a discussion, see Chapter Nine below.

as far as the director's personnel power is concerned, the SEL merely provides that directors may submit to the government departments in charge requests for appointing and removing or engaging and dismissing leading administrative cadres at the level of deputy director, with the exception of those for whom the law and State Council stipulations provide otherwise.¹¹⁹ Such "exception" provisions allow government departments to restrict director's use of this power and to authorise Party secretaries to participate in personnel matters.

It would be an exaggeration to suggest that all the provisions of the SEL can be easily reconciled in one way or another with policy changes. In fact, some SEL provisions remain uncertain. For example, Article 45 of the SEL provides that directors shall be "fully responsible" for the construction of material wealth and morale of the enterprise. But after June 1989, even if directors can dominate enterprise operation, it is doubtful whether they are held "fully responsible" for morale construction. As mentioned earlier, enterprise Party organisations have been authorised to "lead" (lingdao) ideological and political work, though directors still bear "important responsibility" for this work.¹²⁰ Interestingly, in one enterprise whose experience was praised after June 1989, the director was described as "fully responsible" for the ideological and political work.¹²¹ Such description is consistent with the SEL provisions, but appears to contradict prevailing policies. There exists a considerable difficulty in achieving the aim of both upholding the law and preserving new policies.

One additional legal problem concerns legal liability in the event of wrong or illegal decisions and management of enterprises. Party secretaries are called on to participate in

¹¹⁹ Art.45.

¹²⁰ See Answers, supra note 81.

¹²¹ See Liu Bao, "Buguan Dongnan Xibei Feng, Dang de Lingdao Bu Fangsong" (Regardless of the Orientation of the Wind, the Leadership of the Party Should Not Be Relaxed), in RMRB, Aug.28, 1989, p.5.

management, to direct political and ideological work, and to exercise the function of supervision and guarantee, but their liability for such activities is not defined by law. Under the old system of director responsibility under the leadership of the Party Committee, there was no responsibility for either directors or Party secretaries. As the responsibility system has been widely implemented in the economic reforms, Party secretaries' involvement may cause tremendous difficulties in the implementation of any management responsibility system. In this sense, policy changes have not only made the law uncertain, but also added difficulties to the proper implementation of the law.

F. Summary and future prospects

The role of Party committees in state enterprises is a very important issue which has frequently caused difficulties and uncertainties in enterprise management. This is also an issue which reflects the controversial nature of law and politics in contemporary China.

The essential problem appears to be the allocation between enterprise directors and enterprise Party committees of powers and functions with regard to enterprise management. However, the fundamental issue mainly concerns the achievement of socialist aims. State enterprises are not purely economic entities, but fulfil social, and particularly political and ideological responsibilities. The pursuit of economic efficiency may be, if necessary, sacrificed for the sake of political ends.

In this complicated realm, law performs a limited function. On the one hand, the SEL has been employed to establish and defend the authority of enterprise directors. On the other hand, the SEL has not been able to effectively prevent policy changes. This is partly because the SEL is so flexible and loose as to accommodate different interpretations. But more importantly, Party policies, which are described as the "soul" of law, possess overriding force

in the interpretation and implementation of the law. If Party policies change, law has to be understood differently even if its written provisions remain unamended.

The frequent changes concerning enterprise leadership structures largely reflect the concern and indeed the struggle over the balance of powers between directors and Party secretaries, and especially between economic efficiency and political aims of enterprise activities. When economic pursuit is given priority, directors must be authorised with more powers. Conversely, when the political function of enterprises is given emphasis, Party organisations are authorised to play an important role in enterprise management.

As demonstrated in the discussion, it is difficult to achieve a proper balance between directors and Party committees, and between the economic and political pursuits of enterprises. Even if such balance makes sense in theory, it is unlikely to operate reasonably in practice. The enormous policy changes since June 1989 have produced considerable uncertainty and confusion over the status of both directors and Party committees in state enterprises. Such uncertainty has effected the operation of state enterprises.

The issue of Party committees' involvement in enterprise management is not peculiar to Chinese state enterprises. In practice, such involvement may take different forms in different types of enterprises. For example, in collective enterprises, the role of the Party committee is central.¹²² This is mainly because of the public ownership nature of these

¹²² The Regulations Concerning Collective Enterprises in Cities and Towns (1991) provide that the grassroots Party organisations shall be the political leading core of collective enterprises, shall lead the ideological and political work of enterprises, and shall supervise the implementation in the enterprises of the guidelines and policies of the Party and state." (see Art.10). The Regulations Concerning Collective Enterprises in Rural Areas (1990) do not contain such provisions. Nevertheless, from the past experience and in practice, Party committees in rural collective enterprises perform similar functions to their counterparts established within collective enterprises in cities and towns.

enterprises. In Sino-foreign joint ventures, Party committees can only indirectly control enterprise management. Sometimes this takes the form of participation in the management of directors as Party members who should implement decisions and suggestions made in advance by the Party committees established within joint ventures.¹²³ However, there is no evidence to suggest that the Party committees in private enterprises can influence the management of these enterprises.

Since the mid-1980s, in an attempt to promote economic efficiency, the shareholding system, symbolized by the establishment of limited companies, has been experimented with. It was once reported that almost all such limited companies had set up Party committees.¹²⁴ Nevertheless, due to the absence of formal legal provisions, it is difficult to assess the role of Party committees in the management of limited companies. It is likely that, in those newly formed limited companies which are exclusively owned or controlled by public ownership shareholders, Party committees can and will play a notable role in enterprise management. This will, of course, be a major issue for the legislators preparing company regulations, though this might turn out to be more complex due to the potential involvement of private shareholders.

II. Director's Duties: A Legal Analysis

A. Existing law

The above analysis of the legal status of enterprise directors has been carried out from the perspective of the

¹²³ For an example, see Xu Feng, "Yige You Zuowei de Hezi Qiye Dangwei" (A Capable Party Secretary in a Joint Venture), in Jingji Cankao (Economic Reference, Beijing), Nov.6, 1989, p.1. For a general explanation of the role of the Party organisations in Sino-foreign joint ventures, see Chu Baotai and Dong Weiyuan, Waishang Zai Zhongguo Touzi de Falü Wenti (Legal Issues Concerning Foreign Investment in China), Enterprise Management Press (Beijing) 1988, pp.141-43.

¹²⁴ See Cheng Yang, "Chinese Share Companies", Business Law Brief (London, Financial Times), June 1989, p.5.

relationship between directors and Party secretaries. If one would disregard this important perspective, then the starting point for analyzing the legal status of enterprise directors would be the concept of "legal representative" (fading daibiaoren). This concept, which first formally appeared in the ECL (1981),¹²⁵ was developed from a similar term, fuzeren (responsible person), that had been used in relevant legal documents since the early 1950s.¹²⁶ An alternative term for fading daibiaoren is faren daibiao, which literally means "representatives of legal persons".¹²⁷ The GPCL provides that the legal representative of a legal person is the person with management responsibility who, in accordance with law or the provisions of its articles of association, exercise authority on behalf of a legal person.¹²⁸

The primary purpose for adopting the concept of fading daibiaoren is to provide directors or their equivalents with the authority to carry out certain activities on behalf of enterprise legal persons. Although the GPCL does not continue to provide for the coverage of such authority, it is believed

¹²⁵ ECL, Art.31.

¹²⁶ For example, Article 1 of the Measures Concerning the Conclusion of Contracts Between State Organs, State Enterprises and Cooperatives (1950), which for the first time in the history of the PRC used the "legal person" concept, employed the term of "responsible persons". See the text of this document in Chinese, in Laws and Regulations of the PRC Central Government (1949-1950), pp.696-98. The Civil Procedural Law (For Trial Implementation) of 1982, though not recognising the concept of legal person, equated "responsible persons" with "legal representatives". See Art.44.

¹²⁷ See Art.8 of the Provisional Regulations Concerning State Industrial Enterprises (1983).

¹²⁸ GPCL, Art.38. Before this, on Sept.17, 1984, the Supreme Court defined fading daibiaoren as including: (1) chief executives such as the president, manager or chairman of the board of directors; (2) where the chief executive's position is vacant, the vice president or vice chairman or vice manager as the case may be who is actually responsible for the administrative work of the company; where the above positions are all vacant, the persons that are actually in charge of a legal person. See Henry Zheng, China's Civil and Commercial Law, p.312.

that the authority of directors as fading daibiaoren usually exists in three aspects.¹²⁹ First, only the director can sign a contract on behalf of an enterprise of which he is a director. In this respect, unless and until a Party secretary is expressly authorised to act as an agent of the enterprises, he is prohibited from signing a contract on behalf of his enterprise. Secondly, only directors can represent the enterprises in its external relations with its superior government authorities and other entities. Thirdly, only directors can represent enterprises to initiate and defend legal proceedings in people's court.

The implications of the concept of fading daibiaoren on the legal duties of directors are, however, unclear. First, the GPCL definition for this concept itself, which simply provides authority to directors, does not automatically assume any duty for enterprise directors. Indeed, the GPCL, apart from providing that fading daibiaoren may be subject to administrative and criminal liabilities in certain cases,¹³⁰ is silent as to the civil liabilities of enterprise directors. Secondly, even the SEL does not attempt to impose any civil legal duties on directors of state enterprises. As a matter of fact, the SEL was strongly motivated by the idea of increasing the authority of enterprise directors. Accordingly, it lists clearly the authority and powers of directors,¹³¹ but pays little attention to the imposition on directors of civil legal duties. And thirdly, directors' civil legal duties are also neglected by many Chinese legal scholars who are not aware of the existence of this type of duties.¹³²

¹²⁹ See Wang Baoshu and Cui Qingzhi, "Lun Guoying Qiye Changzhang de Falü Diwei" (On the Legal Status of the Directors of State Enterprises), FXYJ, No.5, 1984, pp.49-56, at 53.

¹³⁰ Art.49, GPCL.

¹³¹ Art.45, SEL.

¹³² See Lin Xiangquan and Liu Jianwen, "Xi Qiyefa Guanyu Falü Zeren de Guiding" (On the SEL provisions about Legal Liability), FXPL, No.3, 1989, pp.14-8.

By "civil legal duties", I mean the type of general civil duties which are unconditionally and unilaterally imposed by law, and which are not the result of special civil legal acts such as contracts. Although contractual duty is a type of civil obligation, the occurrence of such obligation must be due to the existence of specific legal relationships between specific persons. In Western company law, the concept of directors' duties is adequately developed, though in practice the contents of this concept may not always be easy to ascertain. For example, in English company law, in addition to statutory provisions, directors' duties are divided basically into two types: one concerns their fiduciary duty, the other concerns their duty of care and skill. It is the fiduciary duty that plays a more important role in controlling the activities of directors. As far as the fiduciary duty is concerned, company directors may be blamed on the basis of either being agents or being trustees of companies.¹³³ Under these types of duties, for example, company directors are legally liable to account to the companies for all secret profits which they made in connection with their capacity as companies directors.¹⁴⁴ Furthermore, a director is forbidden to engage in business that compete with the company of which he is a director. Company directors may even be made accountable to the companies for the "business opportunities" which they once negotiated on behalf of the companies but which were later rejected by the companies.¹⁴⁵

In Chinese law, the law of trust is undeveloped and plays an insignificant role in regulating the legal relations between persons that do not have a formal relationship of

¹³³ See Robert R. Pennington, Directors' Personal Liability, BSP Professional Books (London), 1987, pp.33-58. Also see Farrar's Company Law, Butterworths (London), 2nd edn. 1988, pp.324-43; Boyle and Bird's Company Law, Jordans (London), 2nd edn. 1987, pp.589-90.

¹⁴⁴ One classical case is Regal (Hastings) v. Gulliver (1967) 2 AC 134 (HL).

¹⁴⁵ See Farrar's Company Law, supra note 133.

trust. In no way can an enterprise director be regarded as a trustee of the enterprise. He is therefore not liable to the enterprise in the capacity of a trustee.

It would seem desirable if Chinese law would recognise fading daibiaoren of an enterprise as its agent for the purpose of holding him responsible in certain circumstances. Some scholars make positive assumptions in this respect. For example, Henry Zheng asserts that "the legal representative" is an agent of an enterprise, though "agent" is broader than "legal representative".¹³⁶ However, this assertion is unfounded. First, in the Chinese context, "daili" (agency) differs from "daibiao" (representation).¹³⁷ Secondly, Chinese law recognises only three types of agency relations: "appointment" (weitu), "statutory" (fading), and "designation" (zhiding).¹³⁸ The possibility that fading daibiaoren may fall into the categories of "appointment" and "designation" can be easily excluded because enterprise directors as legal representatives is created neither by appointment nor by designation, but by law. Nevertheless, legal authorization to the effect that directors are the legal representatives of enterprises does not necessarily make fading daibiaoren a type of "statutory agent". This is because Chinese law regards "statutory agency" as the type of relationship resulting from express legal provisions. One example of the statutory agency is the relationship between an incompetent person and his guardian, which is clearly

¹³⁶ See Henry Zheng, China's Civil and Commercial Law, p.312.

¹³⁷ Some writers seem to make no difference between "agency" and "representation". For example, Basic Principles of Civil Law in China (ed. William Jones, M.E. Sharpe, Inc. 1989) translated daili as "representation" (pp.113-23). In addition to the reasons which I shall give in the following discussion, I believe that daili, as a legal term, should be strictly translated as "agency".

¹³⁸ GPCL, Art.64.

identified by the GPCL.¹³⁹ However, neither the GPCL nor the SEL expressly provides that under any circumstances is fading daibiaoren the agent of his enterprise.

Thirdly, the difference between fading daibiaoren and agent is specifically acknowledged by many Chinese lawyers. Fundamentally, in Chinese law (as well as in many other civil jurisdictions), the legal representative is the "organ" (jiquan) which performs civil acts directly on behalf of a legal person. As a result, the legal person's organ constitutes "a unified subject of rights" together with the legal person.¹⁴⁰ The difference between the agent of a legal person and the "organ" of a legal person can be described as: the acts of agents, though having direct legal effects on his principal, are not the acts of the latter; in contrast, the acts of a legal representative are the very acts of an enterprise or institution of which he is the legal representative.¹⁴¹ In other words, fading daibiaoren is not an independent subject of legal relations, but is actually a part of the enterprise as legal person.¹⁴² Consequently, legal representatives and agents represent two different ways by which a legal person carries out its civil activities.¹⁴³

Thus, Chinese law provides no express guidance for establishing agency relations between state enterprises and their directors. Accordingly, it is almost impossible for

¹³⁹ Art.14 of the GPCL provides: "the statutory agent of an incompetent person or a person with limited competence is his guardian."

¹⁴⁰ See Basic Principles of Civil Law in China, supra note 137, p.72.

¹⁴¹ Editorial Committee, Faxue Cidian (Law Dictionary), Shanghai Dictionary Press 1985, p.625.

¹⁴² See Zhu Xisheng and others, Gongye Qiyefa Shiyong Duben (Practical Book on the SEL), Water Conservancy and Electrical Publishing House (Beijing), 1988, pp.193-194.

¹⁴³ For a description of these two different ways, see Basic Principles of Civil Law in China, supra note 137, pp.72-3 (though, as indicated earlier, there are some inaccuracies in the translation).

state enterprises to impose, as a matter of general law, any civil legal duty on their directors. Despite the fact that they are singled out as legal representatives on some occasions, directors are in nature an integral part of state enterprises. Indeed, the difficulties in defining the legal duties of directors of state enterprises are further demonstrated by the ambiguity of the interests which they are obliged to represent. This is also an issue to which the previous discussion on director-Party secretary relations must be referred.

B. Interests of the enterprise

The issue of the interests which an enterprise director should represent has been debated but not yet convincingly settled in Chinese enterprise law. Despite the general acknowledge that there are potential conflicts of interests among the state, the enterprises, and the individuals, including workers and directors themselves. In fact, four kinds of views were aired by Chinese scholars in the mid-1980s in their attempts to tackle such conflicts of interests.¹⁴⁴

The most traditional view was that directors should represent the interests of the state. The main ground for this theory was that directors were appointed by government departments to manage state enterprises. This view was supported by the practice before, and even during the first years of, economic reforms. At that time, state enterprises were merely executors of orders from the government departments which represented the state to supervise enterprises. Because enterprises could not pursue their own interests, it was inevitable that directors should represent only the interests of the state, not of anyone else.

With the progress of state enterprise reform in the mid-1980s, especially after the official authorization of legal

¹⁴⁴ For a summary of different views, see Wang Baoshu & Cui Qingzhi, Jingji Faxue Yanjiu Zongshu (Summary of Research on Economic Law), Tianjin Peoples' Press 1989, pp.76-9.

personality to state enterprises, the issue of directors' accountability immediately came under close attention by many scholars. Most of them were determined to abandon the above described traditional view. Nevertheless they could not agree on the identity of the person or persons whose interests enterprise directors should represent.

Inspired by the government policy on enterprise autonomy, some scholars concluded that enterprise directors should represent the interests of enterprises as independent legal persons.¹⁴⁵ On the one hand, this view originated in the official recognition that directors were the legal representatives of enterprise legal persons. On the other hand, this theory was also strongly motivated by the attempt to separate the interests of the state from those of enterprises. Many scholars who supported this view seemed to hold that there always existed irreconcilable conflict of interests between state enterprises and the state.¹⁴⁶ As such, they argued that directors should represent only enterprises, and not the state.

Some scholars, however, disagreed with this radical view. They raised the possibility that directors should represent the interests of both the state and the enterprises.¹⁴⁷ Many of these scholars were worried about the exclusion of the interests of the state from any practical consideration of directors. Furthermore, they maintained that, despite the fact that enterprises were legal persons, they enjoyed only the right to manage the property. As long as the state remained the sole legal owner of state enterprises, it would be unthinkable for directors to represent only the interests of the enterprises, and not the state. In case of conflict of

¹⁴⁵ See, for example, Huang Zhuozu, "Changzhang (Jingli) Ying Shi Qiye Faren de Daibiao" (Directors (Managers) should be the Representatives of Enterprises), ZGFX, No.2, 1985, pp.10-15.

¹⁴⁶ Wang and Cui, Summary of Research on Economic Law, supra note 144, pp.77-8.

¹⁴⁷ See ibid. p.77.

interests, the interests of the state should be superior to the interests of the enterprises.

Still, some scholars were not convinced by either of these contesting views. They sought to advocate pragmatic ways to deal with this complicated issue. These ways included ideas to adopt different formulas for different enterprises. For example, one author suggested that the legal status of directors should be determined by the size and the economic significance of the enterprises of which they were directors.¹⁴⁸ Thus, directors of enterprises that were crucial to the national economy should only be responsible to the state; directors in small enterprises should only be responsible to the enterprises; and directors in other medium-sized enterprises should be responsible to both the state and the enterprises. In addition, some scholars also suggested that the status of enterprise directors should be decided in light of the leadership system and "the management pattern" (jingying fangshi) which relevant enterprises actually applied. For example, in terms of the management patterns, directors of enterprises which adopted the director responsibility system should represent the interests of both the state and the enterprises, but those which were managed on the basis of the contracting (chengbao) system should only represent the interests of the enterprises.¹⁴⁹

These different views reflected the confusion which existed among Chinese scholars with respect to the legal status of enterprise directors. Fundamentally, such confusion can be seen as a result of the growing contradictions between the interests of the state, enterprises and individuals in

¹⁴⁸ Su Wanjue, "Quanmin Suoyouzhi Qiye Changzhang (Jingli) Shengfeng Zhi Wojian" (My Opinion on the Status of Directors and Managers of State Enterprises), FXJK, No.4, 1985, pp.32-3.

¹⁴⁹ For a description of this view, see Wang & Cui, Summary of Research on Economic Law, supra note 144, pp.78-9. This view is apparently wrong in that the director responsibility and the chengbao systems have been separated. In practice, as shown in Chapter Nine, these two systems are implemented together.

economic reforms. Since enterprises were granted more autonomy over their management, enterprises, their directors, and workers sought to take advantage of this new policy to protect and expand the newly recognised interests of their own. In many cases, this undermined the interests of the state, therefore causing tensions between the state and government departments on the one side and enterprises and their workers and managers on the other.

Even in the West, the ^{complexity of} interests involving limited companies is not an issue that can always be easily resolved. For example, English company law, by referring to company directors as either agents or trustees of companies, requires them to act bona fide in the interest of the company. However, in practice, "the interest of company" eludes simple definition.¹⁵⁰ In most cases, it means the interests of the shareholders;¹⁵¹ in some cases, it extends to the interests of the creditors;¹⁵² still at least as recognised by law,¹⁵³ the interests of the company shall also embrace those of the employees.¹⁵⁴ In some cases, the interest of the company may be construed as to include that of the customers, the state and the general public.¹⁵⁵

As discussed earlier, some Chinese scholars did suggest that enterprise directors should represent the "interests of

¹⁵⁰ See Farrar's Company Law, supra note 133, pp.325-29; Boyle and Bird's Company Law, supra note 133, pp.592-94.

¹⁵¹ Farrar's Company Law, ibid. pp.329-32.

¹⁵² Ibid.

¹⁵³ Companies Act 1985, S.309.

¹⁵⁴ English case law has not developed to a significant degree as to protect the interests of employees, though such interests are widely protected in continental Europe such as France and Germany. For an analysis of the difficulties with regard to the protection of employees' interests in English law, see Pennington's Company Law, 6th edn., Butterworths 1990, pp.584-85.

¹⁵⁵ See Boyle and Bird's Company Law, supra note 133, p.592.

the enterprises". This idea appeared similar to English law concerning the "interest of the company" in the respect of directors' duty. However, clarification and development of this idea was hardly possible because many scholars were determined to assume the irreconcilable contradiction of interests between enterprises and the state. Consequently, the "interest of the enterprise", as comprehended by many Chinese scholars, did not consider the interest of the state as a constituent part of the "interest of the enterprise" as a whole. In other words, significant differences still existed between the Chinese perception of the "interest of the enterprise" and the English approach of the concept of the "interest of the company". On the other hand, even if the Chinese authorities were persuaded to accept the approach of English law towards directors' duty, the law would not work if, as the case is, directors were not legally identified as the agents or trustees of the enterprises.

It seems that the only way out of this confusion would be, first, to recognise through express legal provisions the status of directors as either agents, appointees, or trustees of state enterprises.¹⁵⁶ This would require a new explanation of the existing concept of fading daibiaoren. Indeed, the threat to impose administrative and criminal liability on fading daibiaoren, as provided in the SEL, suggests no more than the "duty of care and skill" as recognised throughout Western company law. Moreover, the present explanation of the concept of fading daibiaoren does not indicate any fiduciary duty on directors, which has been used in the West as the most effective weapon in preventing and correcting the improper activities of directors. As a second step, the law should expressly provide that an enterprise director shall represent the interests of the enterprise as a whole, that is, the interests of the state, workers, creditors and even directors.

¹⁵⁶ Art.192, par.3 of the Company Law (Taiwan) provides that the relationship between the company and its directors shall apply the civil law relationship of "appointment" (weiren) except where otherwise provided by the law.

The law should also provide that, in case of disputes concerning the alleged improper treatment of different interests, it is the court that shall make a final judgment on relevant issues.

Many problems, however, would still have to be addressed before the above suggestion could be attempted. The most important is, of course, the proper treatment of Party secretaries in enterprises. If they continue to hold significant powers in relation to enterprise management, the imposition on enterprise directors of legal duties as strict as those existing in the West would never be fair. One way which might be helpful is to treat Party secretaries as "shadow directors" of the enterprises, a concept which has been widely employed in, for example, the English Companies Act.¹⁵⁷ In this way, Party secretaries would be made accountable to enterprises if they were found to be wholly or partly responsible for the illegal or improper activities and decision-making in managing enterprises.

Secondly, the aims and purposes of the enterprises' activities must be further clarified. Fundamentally, enterprises are not legally recognised as entities which should always pursue economic profits. Political or other tasks may still be very important in assessing the performance of state enterprises. In addition, government intervention, state economic plans, and many other factors make it more difficult to achieve a proper balance between the interests of the state and those of the enterprise. Indeed, any consideration of the interests of the enterprises should take into account the vertical administrative relations existing between state enterprises and the government departments in charge. As a matter of fact, the administrative responsibility of enterprise directors towards the government, as provided by

¹⁵⁷ Companies Act 1985, S.741 (2) provides: "in relation to a company, 'shadow director' means a person in accordance with whose directions or instructions the directors of the company are accustomed to act. However, a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity."

the GPCL¹⁵⁸ and the SEL,¹⁵⁹ is so persuasive as to put the interests of the state above those of others. In the end, the difficulties in treating properly various interests are very likely to continue if the state remains the sole legal owner of state enterprises.

Thirdly, the political accountability of directors towards enterprises' superior authorities remains a difficult problem. Until this issue is addressed, directors' political accountability may override the legal treatment and technical evaluation of conflicting interests involved in state enterprises as legal entities.

Finally, the law must also indicate which persons are entitled to challenge the actions taken by enterprise directors. Presumably, such persons should include the state as the owner, creditors of the enterprises, and workers. Obviously, the person (or government department) who is to represent the state in legal actions against the directors must be properly defined in order to avoid the immense administrative pressure currently resulting from the involvement of many government departments.¹⁶⁰ At least, the law which provides that directors of state enterprises may be appointed by the government departments in charge¹⁶¹ should be amended or repealed. Instead, enterprises should be given more power to elect their directors or veto the decision made by relevant government departments for the appointment of directors.

Whatever the problems, the urgency to solving the confusion concerning the legal duty of directors is present as ever. Since 1987, the most popular method used for holding enterprise directors responsible has been carried out by the contracting (chengbao) system. Detailed analysis of this

¹⁵⁸ Art.49.

¹⁵⁹ Arts.62 and 63.

¹⁶⁰ For an analysis, see Chapter Four of the thesis.

¹⁶¹ SEL, Art.44.

system is provided in Chapter Nine of this thesis. It suffices here to point out the fundamental shortcomings existing in the legal duties of enterprise directors which contribute to the failure of the chengbao system.

Under the current chengbao system, enterprise directors are bound only by the flexible criteria provided in the chengbao contracts that are signed between relevant government departments in most cases and the enterprises represented by their directors. Under relevant regulations,¹⁶² if enterprises fail to carry out the targets as provided in chengbao contracts, they, together with enterprises, have to bear the responsibility. In some cases, an enterprise director may be compelled to hand over to the government the amount of the property or fund which was defined by relevant contracts as compensation for failing to fulfil the contracts. In addition, enterprise directors may be asked to transfer to the state the property they undertook as security for their leading role in negotiating and carrying out chengbao contracts. However, even if these remedies against directors may be reasonably expected, directors are still not yet put under a general legal duty to act bona fide in the best interests of the enterprises as a whole. For example, wary of the threat that the government may amend the contract to increase the settled target figure in the chengbao contract, directors tend to just meet such targets. This means that in many cases, directors do not pursue the best possible results for their enterprises.

On the other hand, directors are not likely to be made accountable to the enterprises for secret profits which they make in connection with their capacity as enterprise directors. Most significantly, the issue of corruption can be partly attributed to the lack of effective legal control on the activities of enterprise directors. In some cases, directors' growing authority may lead to directors' seriously

¹⁶² See Provisional Regulations Concerning the Contracting Management Responsibility System of State Industrial Enterprises (1988).

abusing their powers granted by law. In the campaign to crackdown on corruption, many directors who are found guilty of corruption are prosecuted and punished, and their illegally-obtained profits confiscated. However, criminal penalties are only applicable to cases of serious abuses. Furthermore, in criminal proceedings, the profits which directors made by illegally using their powers and influence are handed over to the state, and not to the enterprises which are the direct victims. At least in this sense, the interests of the state are again privileged, making the "interests of enterprises" more uncertain.

It is therefore necessary for Chinese reformers to establish the concept of the interests of the enterprises as a whole in order to combat the corruption and abuse of power by enterprise directors. Such a concept would contribute to a proper clarification and treatment of different interests involving state enterprises. In the future, the establishment and clarification of this concept, together with the proper definition of the directors' legal status, would help the development of all aspects of China's company law.

III. Conclusion

This chapter has examined the complex issue of the legal status of enterprise directors. It has been demonstrated that this issue has not been satisfactorily resolved in the post-Mao reforms. On the one hand, despite that directors were accorded by the SEL of 1988 the "central" position in enterprise management, their position has been less secure as a result of policy changes since June 1989. On the other hand, the legal duties of enterprise directors are unsettled. Directors are hardly accountable to **enterprises** for their improper or illegal activities. The state tends to place its interests as a priority in the treatment of different and often conflicting interests among the state, enterprises, creditors, workers, and directors.

In fact, the legal status of enterprise directors is

controversial and uncertain. A director has neither been given sufficient power to manage the enterprises, nor been put under a proper legal duty to act in the best interest of the enterprise as a whole. To a certain extent, it is due to the unsecured position of enterprise directors in respect of management that a proper development of directors' duties has not been possible in PRC law.

State and Party policies have played a dominant role in shaping and developing the legal status of enterprise directors. The SEL confirmed the then prevailing policy of the director responsibility system. But policies remained important in the interpretation and implementation of legal provisions. Furthermore, the written law has been unable to effectively withstand subsequent policy changes which have taken place since June 1989.

The political leadership of Party committees over enterprise management and the preferential treatment of the interests of the state cause considerable difficulties in transforming the enterprise leadership system. These areas also feature as the most sensitive and difficult aspects in the comprehensive legal regulation of state enterprises in the era of economic reforms. Unless there are fundamental political and policy changes, these problems will continue to frustrate Chinese reformers.

CHAPTER SEVEN

WORKERS' PARTICIPATION IN ENTERPRISE MANAGEMENT

This chapter examines workers' participation in the management of Chinese state enterprises. After an introduction of basic concepts and the history of workers' participation in socialist China, the discussion examines the role currently played by the institution of the worker -- staff congress (the "WSC") in enterprise management. The role of the WSC is then evaluated, and comparisons made with workers' participation as practised in Germany. Finally, a conclusion is offered.

I. Introduction

A. Basic concepts

According to socialist theory, workers in socialist public ownership enterprises are not mere employees. From an orthodox socialist viewpoint, the term "employee" implies exploitation which should be eliminated in socialist public ownership enterprises. The PRC leadership has inherited such a distinction and used various terms very cautiously. Thus workers and staff in all enterprises, whatever types of ownership they operate under, can be called zhigong, and "workers" may also be narrowly described as gongren. But it is only in private enterprises and foreign investment enterprises such as Sino-foreign joint ventures that workers may be called "employees" (gugong or guyuan).¹

¹ See, for example, the Provisional Regulations on Private Enterprises (1988): gugong (Art.2) and zhigong (Art.4). In fact, workers in joint ventures are usually called

Despite the considerable growth of private and foreign investment enterprises in the last decade, Chinese socialist views on labour appear to have experienced little change. Labour is not officially regarded as a commodity, at least as far as state and collective enterprises are concerned. Until the early 1980s, state enterprises had little autonomy in selecting workers but had their workforce assigned to them by government authorities in accordance with state plans. Immovability of workers from one unit to another, or from one area to another, was so marked that inefficient production became inevitable.

In late 1986, the Chinese government introduced the labour contract system in an attempt to promote economic efficiency as well as flexibility on relations between state enterprises and their workers.² But the new labour contract system has encountered many social, economic and ideological challenges and has not been effectively implemented.³ Until 1990, only 12.2 per cent of workers and staff in all state enterprises had been employed on the basis of labour contracts.⁴ Moreover, despite their contractual relationship with enterprises, workers must not be treated as mere employees as those in private companies. In fact, it is difficult for labour contracts to play a decisive role in

zhigong instead of gugong.

² See four Provisional Regulations, on Implementing Labour Contract System, on Recruiting Workers, on Dismissing Workers Violating Disciplines, and on Insurance for Unemployed Workers. All were promulgated by the State Council on Jul.12, 1986 and effective as of Oct.1, 1986. See the text in Chinese, in Laws and Regulations of the PRC (1986), pp.775-93.

³ For a discussion of these difficulties, see G. White, "The Politics of Economic Reform in Chinese Industry: the Introduction of the Labour Contract System", China Quarterly, No.111, 1987, pp.365-89. Also see Hilary K. Josephs, "Labour Law in the Workers' State: The Chinese Experience", Journal of Chinese Law, 1988, pp.201-63.

⁴ RMRB, Dec.17, 1990, p.3. The number was 12.36 million. This number increased to 15.34 million by the end of 1991. See RMRB, Apr.25, 1992.

transforming the previous enterprise system under which workers felt little pressure from enterprises. This is not only because of the apparent ideological concern over the officially alleged "master" or "owner" (zhuren) status of workers, but also due to many other objective difficulties in enforcing the labour contract system. One of the most notable difficulties has been the lack of an appropriate social security system which can provide for unemployed workers and therefore prevent social unrest.

Since 1991, in order to enhance economic efficiency and productivity, a new drive has been launched to further the implementation of the labour contract system in all state enterprises. However, given the notable opposition from workers, it remains to be seen whether the new campaign will be successfully carried out and whether the new system would bring fundamental changes to the old enterprise employment system.

The legal status of state enterprise workers is officially founded on two basic factors. On the one hand, workers are labourers. It follows that they are in a position similar to workers of non-state enterprises. On the other hand, since every state enterprise is officially termed as "an enterprise owned by the whole people", every citizen, including a worker, is nominally deemed to be an owner of a state enterprise. It follows that workers are automatically entitled to participate in enterprise management. But the dual status of workers in state enterprises also brings difficulties and confusion. For example, the claim that workers are owners of state enterprises has contributed to the job security system in which workers have little worries about their future employment. And this job security system has in turn blocked current labour reforms and the introduction of a labour contract system. On the other hand, the dual status of workers, particularly their "owner" status, has affected in many ways the issue of workers' participation in enterprise management.

B. Workers' participation: a brief history

In China, workers' participation is usually described as "democratic management of enterprises" (qiye minzhu guanli). Throughout the history of the CCP, workers' participation has been implemented in many different ways with different emphases and, of course, different results. It has also experienced ups and downs.

As shown in Chapter Six, for many years after the 1930s, directors had overall control of socialist state-owned factories. Although party secretaries and presidents of the trade unions in state enterprises had the access to participate in enterprise management, they were largely excluded from making final decisions concerning enterprise management. Furthermore, there was no fixed organisation besides the trade union in state enterprises to channel the exchange of opinions between directors and workers.

In August 1948, the Sixth National Labour Congress, held in Harbin, Heilongjiang Province, in its "Resolution on Current Tasks of Chinese Workers' Movement", for the first time proposed the establishment of "the worker -- staff representative conference" (zhigong daibiao huiyi, hereinafter "Conference") in enterprises. This Congress also revived the All-China Federation of Trade Unions which formerly appeared in the 1920s. One year later, on August 10, 1949, the People's Government of Northeast China promulgated the Implementing Regulations Concerning Establishing the Factory Management Committee and the Conference in State-Owned and Public-Owned Factories and Enterprises.⁵ These Implementing Regulations, which were later recommended by the Central People's Government as a model to be extended to the whole country, provided that

every state-owned or public-owned factory which has more than 200 workers must organise workers' representative conference. A factory which has less than 200 workers shall not organise the Conference, but the assembly of

⁵ See the text in Chinese, in Selected Enterprise Laws and Regulations, pp.11-5.

all workers must be convened by the president of the trade union once or twice every month.⁶

Moreover, representatives to the Conference were to be elected from grass-root production units, to which representatives were responsible.⁷ To some extent, the Conference operated as a check on the factory management committee. For example, it could listen to and discuss reports made by this committee, examine the committee's operation and management and its "leading style" (lingdao zuofeng),⁸ criticise the committee, and make suggestions to the committee. On the other hand, however, no resolution made by the Conference concerning the administration of the factory (or enterprise) was effective unless it was endorsed by the management committee and promulgated as an order by the director.⁹ Thus, the Conference only operated as a supervisory body. It was put under the control of the factory management committee chaired by the director.

The Implementing Regulations also closely linked the Conference with the trade union organisation. Basically, the Conference was regarded as a meeting of representatives from the trade unions of the factory.¹⁰ All resolutions adopted by the Conference and concerning the affairs of the trade union had to be fully implemented by the trade union committee of the factory. Such a committee could not alter any resolution adopted by the Conference without a decision to such effect from a superior trade union committee.

The close link established between the Conference and the trade union appears to be the necessary result from the idea

⁶ Art.14.

⁷ Art.15.

⁸ In the Chinese context, lingdao zuofeng is usually understood to refer to both the ways which the leaders of the factories treat their workers and the ways through which they make their decisions.

⁹ Art.20.

¹⁰ Art.21.

that workers were labourers as well as owners of state and public enterprises. Such a link was meant to ensure that workers had the opportunity to participate in factory management. But this link also had serious implications. The most obvious implication was the confusion over the powers and authority of the two institutions. According to the PRC Trade Union Law of 1950,¹¹ the trade unions in state and cooperative enterprises were entitled to represent workers and staff to participate in the operation and management of the enterprises.¹² This unavoidably led to the confusion regarding the function of the Conference. Furthermore, as will be revealed later, the link between the Conference and the trade union had also provided an opportunity for the trade union to control and even to supersede the formal organisations facilitating workers' participation.

The early practice of workers' participation was not very successful. A detailed examination of Chinese industrial enterprises during the period of 1948-1953 suggested a "pessimistic" view.¹³ This was underlined by the fact that in many enterprises the Conference was not convened regularly. Moreover, the Conference did not possess significant decision-making power. Nor did the Conference even discuss management issues in a serious way. It was also revealed that the lack of success in the democratisation of enterprise management was due less to the political and structural aspects of participatory organisations than to the management forms of enterprises.¹⁴ The reason for this was that it was difficult to reconcile workers' participation with the Stalinist one-man

¹¹ Adopted on Jun.28, 1950. See the text in Chinese, in Laws and Regulations of the PRC Central Government (1949-1950), pp.41-7, at p.42.

¹² Art.5, ibid.

¹³ William Brugger, Democracy and Organisation in the Chinese Industrial Enterprises (1948-1953), Cambridge University Press (London) 1976, p.254.

¹⁴ Ibid. p.250.

management system.¹⁵ Under the one-man system, even the management committee, being effectively controlled by the director, could not play a full role. Treated even worse by enterprise directors was the Conference which, if functioned actively, could often bring much embarrassment to themselves.¹⁶

In 1956, the Eighth National Congress of the CCP proposed the establishment in enterprises of the workers' / staff's congress (zhigong daibiao dahui, "WSC"), which was actually an evolution from the previous Conference. This WSC system was subsequently confirmed in the Regulations Concerning the Work of State Industrial Enterprises (Draft) promulgated by the Central Committee of the CCP on September 16, 1961.¹⁷ Nominally, the WSC was defined as an important institution for attracting workers and staff to take part in enterprise management and to supervise enterprise administration. In addition to the power to discuss and resolve important issues concerning enterprise management and other issues of workers' concern, the WSC was given a number of powers. These included the powers

to criticise any enterprise leader, to make suggestions to the superior authorities to sanction, dismiss and change enterprise's leading cadres who are delinquent and whose working style is bad; and even to complain to higher levels by bypassing the immediate leadership.¹⁸

Thus, except for that provisions were more concrete, the powers of the WSC remained similar to those given to the Conference. Of course, there were some procedural changes. While the Conference was required to meet twice a month, and no meeting was to last for longer than half a day, the WSC should meet at least four times a year, but no maximum time

¹⁵ Ibid. For a discussion of this system, see Chapter Six of the thesis.

¹⁶ Ibid., pp.232-33.

¹⁷ See the text in Chinese, in Selected Enterprise Laws and Regulations, pp.45-72. See Art.60.

¹⁸ Art.60, par.3, ibid.

limit for one meeting was imposed. When the WSC was not in session, representative groups should be formed on the basis of production or working units in order to report frequently the opinions of workers and the masses and to supervise and examine the implementation of resolutions adopted by the WSC. The most fundamental change, however, was that the trade union was expressly authorized to preside over the day-to-day work when the WSC was not in session. The implication was that, from then on, the trade union took full control over the WSC and workers' assembly.

The WSC system was introduced after the completion in 1956 of the "reform of bourgeois industry and commerce." As discussed in Chapter Six, the Eighth National Congress of the CCP held in 1956 also ended the one-man system which had been practised since the late 1940s, and replaced it with the system of director responsibility under the leadership of the Party Committee. The immediate result was that the Party Committee in enterprises took unified control over enterprise's management. The Working Regulations on State Industrial Enterprises (Draft) of 1961, which formally confirmed all the changes that had taken place within state enterprises since 1956, also expressly put enterprise trade unions under the leadership of the Party Committee.¹⁹ Consequently, the role of the trade union had to go through changes. Although the trade union was still regarded as a mass organisation designed to attract workers to participate in enterprise management, its ideological functions were strengthened. The main tasks for the trade union were set as mobilising and organising workers to enhance production; promoting workers' ideological and political "consciousness"

¹⁹ Art.59. For most of the years since 1949, in addition to the leadership of the Party, Chinese trade unions have been put under both vertical (national) and regional (local) control of the trade union trade union organisations. On the whole, Chinese trade unions within enterprises have played a minor role in enterprise management. For a comprehensive study of the policy and practices concerning Chinese trade unions, see Lee Lai Tao, Trade Unions in China, Singapore University Press 1986.

(jüewu) as well as cultural and technical knowledge; reporting as quickly as possible opinions and requests of workers; preserving workers' democratic rights and improving workers' living welfare.²⁰

On the other hand, some provisions of the 1950 Trade Union Law²¹ were made practically obsolete. For example, trade unions no longer represented workers in their bargaining with enterprise administration. Nor did it have the power to raise any objection against the dismissal of workers, though in fact dismissal did not happen often at that time. In a word, the trade union was put in a position to promote harmony and mobilise workers rather than to disrupt the order and authority in an enterprise. In addition, the trade union was also required to become a "strong assistant to the Party in contacting the masses in enterprises".²² As a result, the trade union committee received orders from the Party committee, and carried out such functions as worker mobilisation and motivation, dissemination of information, slogans, wall posters and after-hour study sessions.²³

The implementation of the WSC system appeared to have made some progress at an early stage. During the Great Leap Forward of the late 1950s, the Chinese authorities introduced a new idea known as "two participation" (cadre participation in manual labour and workers' participation in management), "one reform" (reform of irrational rules and regulations) and "three integrations" (integrations of management cadres, technicians and workers). This system put emphasis on the ability of workers and did to some extent boost workers' enthusiasm for participating in management. According to a

²⁰ Art.58.

²¹ A new Trade Union Law has been adopted by the NPC on Apr.3, 1992. For the text of this Law in Chinese, see GRRB, Apr.8, 1992, p.1.

²² Art.58, supra note 10, p.68.

²³ Barry Richman, Industrial Society in Communist China, Random House (New York) 1969, p.763.

survey conducted in 1966, despite the decline of the role of the trade unions, workers' participation in China was seen as "rather effective",²⁴ at least in terms of economic or technical results. Workers' participation was actually more active and effective in informal meetings of both workers and enterprise cadres rather than in formal meeting of the WSC which was only accessible to selected representatives.²⁵ Workers discussed many matters including the issue of bonus distribution. Although it was rare for the WSC to ask government authorities to dismiss enterprise directors, it was not impossible for workers to elect their directors. Of course, like many other activities of workers, every election was arranged and subject to approval by the Party committee in the enterprise, not to mention superior government and Party organisations.²⁶ After all, workers' participation in management was seen as having some favourable effects with respect to economic and technical performance as well as political and ideological aspects.²⁷

The enormous social changes that took place in China from the late 1950s to the late 1970s were in their nature waves of mass movement. Although workers participation in management was hardly doubted by anyone at any time, it is difficult to give a detailed account of the forms for realising such participation. This is mainly because such forms actually varied from enterprise to enterprise, and from time to time. For example, during the late 1960s and the early 1970s, the Beijing General Knitwear Factory experienced three kinds of mass organisations -- the Workers' Management Teams, the Red Guards, and the Revolutionary Committees.²⁸ Although each type

²⁴ Supra note 13, p.257.

²⁵ Ibid., p.254.

²⁶ Ibid., pp.255-56.

²⁷ Ibid., pp.256-57.

²⁸ Charles Bettelheim, (translated from French by Alfred Ehrenfeld) Cultural Revolution and Industrial Organisation in China, Monthly Review Press (New York and London) 1972, pp.21-

of organisation had a different composition and played a different role, all three provided opportunities for workers' direct participation in enterprise management. However, since the mid 1970s, the Revolutionary Committees and Workers' Management Teams began to be dismantled and then finally disappeared, though some work teams remained important.²⁹ As a whole, the mass movement and workers' participation in this period accompanied turmoil and destruction of organisations in Chinese enterprises. The WSC totally disappeared from the scene of enterprises. Even the Party committee was put aside between 1966 and 1969. Since managerial and professional authority was disrupted seriously during the cultural revolution, this kind of workers' participation can hardly be judged in terms of economic efficiency.

II. Workers' Participation in the Era of the Economic Reforms

A. Revival of the WSC system

The revival of the WSC system in Chinese state enterprises did not take place until 1979. At first, when some enterprises were chosen to experiment with the directors responsibility system, most enterprises were simply ordered to restore the system of director responsibility under the leadership of the Party committee. Concurrent with this development was the restoration of the system of WSC under the leadership of the Party committee.

When China's modernisation drive was launched in the late 1970s, it was believed by the Chinese leadership that workers' cooperation could play a decisive role in industrial reforms. The only problem was how to mobilise workers and to bring into play their enthusiasm. On the other hand, from the outset,

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²⁹ Martin Locket, Cultural Revolution and Industrial Organisation in a Chinese Enterprise: the Beijing General Knitwear Mill 1966-1981, Management Research Paper, the Oxford Centre for Management Studies, 1985.

state enterprise reform gradually reduced government control over enterprises. Since enterprises were to be steadily endowed with more powers, the Chinese leadership was very concerned about the possible misuse of these newly-allocated powers. An immediate step was to find a mechanism ensuring the proper exercise of these powers. In this respect, the authorization of more powers to the WSC was seen as not only a legitimate but also a less controversial way to ensure the proper functioning of enterprise autonomy policy.

In October 1978, when addressing the Ninth National Trade Union Congress on behalf of the Central Committee of the CCP and the State Council, Deng Xiaoping said:

To bring about the four modernisation, all our enterprises must, without exception, practise democratic management and combine centralised leadership with democratic management. From now on, workshop director, section chiefs and group heads in every enterprise must be elected by the workers in the unit concerned. All major issues of the enterprise must be discussed by the WSC or workers' general assembly.³⁰

Unlike its predecessors, the WSC in the late 1970s and early 1980s seemed to reemerge as an organ of real power. On July 13, 1981, the Central Committee of the CCP and the State Council transmitted the Provisional Regulations on Worker -- Staff Congresses in State Industrial Enterprises³¹ (hereafter "Provisional Regulations"). These Provisional Regulations, which were jointly drafted by the All-China Federation of Trade Unions, the State Economic Commission, and the Department of Organisation of the CCP, were the first formal document exclusively dealing with the WSC. The promulgation of these Provisional Regulations also revealed that, compared with the Party committee and the director, the WSC was the first important institution within a state enterprise to receive formal and systematic treatment after the commencement of post-Mao economic reforms.

Article 5 of the 1981 Provisional Regulations provided:

³⁰ RMRB, Oct.12, 1978, p.2

³¹ See the text in Chinese, in Bulletin of the State Council, No.16, Sept.25, 1981, pp.489-93.

The WSC shall exercise the following functions in accordance with state policy, decree, and the requirements of plans:

(1) discuss, examine and adopt resolutions on the work report submitted by the factory director, the production and construction plans, the budgets and final accounts, and major issues concerning important technical innovations and management;

(2) discuss and decide on the issue of the funds for labour protection, the welfare funds for the workers and staff, and the funds for bonus, as well as other issues of vital interests to the workers and staff, such as the regulations for awarding and punishing workers and staff members and the allocation of housing facilities for workers and staff;

(3) discuss and adopt resolutions on matters related to the plans for the enterprise organisational reform, plans for wage adjustment, plans for the training of workers and staff, and major rules and regulations to be applied throughout the enterprise;

(4) supervise leading cadres and staff at all levels in the enterprise. The WSC may recommend those cadres who work hard and have a record of success to the higher authority for recommendation or, in the case of outstanding achievements, promotion of administrative position and salary. The WSC may also propose to the higher authority to criticise, punish or dismiss cadres who cause losses as a result of negligence of duty; it may propose to the Party discipline inspection organs and state judicial organs actions against cadres who are guilty of dereliction or serious violation of law or discipline;

(5) elect enterprise administrators in accordance with guidance set by the higher authority, subject to approval and appointment by the government authorities in charge of the enterprise concerned.

Thus, the powers of the WSC as provided in the Provisional Regulations were very comprehensive and broad. A full implementation of these powers would have suggested that the WSC was the principal source of power and authority within a state enterprise. In practice, however, these powers were executed to varying degrees in different enterprises. The WSCs in some enterprises fully implemented their powers. But in many enterprises, the WSC did not enjoy the powers as provided by the Provisional Regulations. Harry Harding in 1987 described the Chinese WSC as merely an advisory or

consultative organ.³² David Granick,³³ on the basis of case studies conducted between 1982 and 1985, also reached a similar conclusion. He suggested that the normal pattern was that the WSC only had "the right to discuss problems of prime importance to the enterprise and to decide matters having to do with the allocation of welfare benefits and of special individual awards".³⁴ The WSCs could hardly make decisions of their own on such other matters as enterprise production and management.

B. Reasons for the inactivity of the WSC

Many reasons contributed to the inactivity of the WSCs. In fact, many of these reasons are still present and affect the proper functioning of the WSC system in contemporary Chinese state enterprises.

First, the relationship between the WSC and government authorities was not clear. For example, Deng's speech in 1978, cited earlier, seemed to suggest that the WSC should be granted the power to elect directors and other administrators of an enterprise. But the Provisional Regulations imposed restrictions on this power and, as a result, the election of directors had to be subject to government approval. As far as the relationship between the WSCs and government departments is concerned, the Provisional Regulations provided that:

the WSC may express its opinion if it disagrees with any decisions or directives of a higher authority. But if the higher authority upholds its original decision or directive after deliberation, the WSC must implement it.³⁵

Thus, government departments had ultimate control over the

³² Harry Harding, China's Second Revolution, The Brookings Institution (Washington) 1987, p.181.

³³ David Granick, Chinese State Enterprises, University of Chicago Press 1990, p.239.

³⁴ Ibid. p.181.

³⁵ Art.7.

WSCs. In an attempt to explain such tight government control and the relative independence of the WSCs in state enterprises, a Chinese economist observed

democratic management must combine both national and local interests. On the one hand, the power of the workers' congress is limited in that it comes under the guidance of state plans and must be subordinate to the need to uphold the ownership of the whole people. On the other hand, national interests and unified planning must be based on worker enthusiasm and the democratic power of independent management in that enterprise.³⁶

According to this explanation, the WSC which tends to represent an enterprise's own interests should always be subject to the control of government departments which have to take into account broad national and regional interests. As explained in Chapter Six, a director in a state enterprise must not overemphasize the interests of the enterprises. Instead, he must represent the interests of the state as a priority. Accordingly, the election by the WSC of enterprise managers has to be approved by government departments. In contrast, "as for each collectively owned enterprise, the workers' congress or general assembly should be the highest agency of power".³⁷

Secondly, the institutionalisation of the WSC did not make much progress. Compared with the WSC system practised before the Cultural Revolution, the 1981 Provisional Regulations made several changes. A presidium was introduced to preside the meetings of the WSC. This presidium should comprise workers, technicians, management staff and major leading cadres from the Party committee, the management, the trade union and the Communist Youth League organisation. And in most circumstances, the number of members selected from workers should be more than half. The WSC should meet at least once every six months. Every meeting should be attended by more than two thirds of all representatives. When important

³⁶ Xiao Liang, "Changing the Leadership System in State Enterprises", in Wei and Chao (ed.), China's Economic Reforms, University of Pennsylvania Press 1982, pp.147-58 at 154.

³⁷ Ibid.

issues had to be discussed, a temporary meeting might be held at the request of one third of all representatives. Elections and resolutions were only effective if they were made with the approval of more than half of all representatives.

Despite these provisions, the WSCs were not properly institutionalised. It was explicitly provided that "normally the WSC shall not set up any standing organ".³⁸ As in the situation which prevailed before the Cultural Revolution, a grassroots trade union committee was to act as the working body for the WSC. And the committee should prepare, organise the meeting of the WSC, and carry out the day-to-day organisational work when the WSC was not in session. Moreover, the committee might also carry out jobs assigned by the WSC or its presidium.³⁹

Thirdly, the WSC was explicitly put under the direct leadership of the Party Committee.⁴⁰ The Provisional Regulations did not provide for the method by means of which the Party Committee was going to "lead" the WSC, except that it authorised leading cadres from the Party committee to sit as members of the WSC's presidium.⁴¹ In practice, the control by the Party committee could be seen in two aspects. The first was that the Party committee was entitled to control the trade union committee which was the working body of the WSC. And the second aspect was more fundamental as the Party committee might intervene directly into the operation of the whole WSC system, from the election of representatives to the arrangement of agenda for the meeting of the WSC.

Last, but not least, the WSC was in a difficult position in dealing with enterprise directors. The Provisional Regulations provided that:

The director shall report his work regularly to the WSC, and shall be responsible for implementing and handling

³⁸ Art.11.

³⁹ Art.16.

⁴⁰ Arts.1 and 3.

⁴¹ Art.11.

the resolutions and "suggestions" (ti'an) made by the WSC in relation to enterprise production and administration, and shall accept the examination and supervision by the WSC. The WSC shall support the director in exercising his powers and shall preserve his high authority in production management system, and educate workers to improve their sense of being the owners of the state, to voluntarily comply with labour discipline and to strictly implement all production or technology responsibility system.⁴²

Despite this broad declaration, a clear way to implement these ideas was not really worked out. In fact, legal provisions themselves were far from clear.⁴³ Many questions were not answered. For example, the meaning of "examination" and "supervision" was not clear. The differences, if any, between "discuss and deliberate" and "discuss and decide" is unknown. In addition, the coverage of matters on which the WSC might adopt binding resolutions was not clarified. In practice, these issues were very confusing. For example, as one observer found,⁴⁴ although the WSC might discuss and raise suggestions on some matters put forward by the director or by the Party committee, it was common that the WSC had no other option but to agree to the original proposals.

The Provisional Regulations were applicable only to those enterprises which restored the system of director responsibility under the leadership of the Party committee. Since the early 1980s, however, a number of enterprises were chosen to experiment with new leadership systems. In some enterprises, the overall leadership by the Party committee was replaced by "the system of director responsibility under the leadership of the WSC" (zhigong daibiao dahui lingdao xia de changzhang fuzezhi). This system represented an attempt to combine "democratic management" with the establishment of a new leadership system. Under this system, the WSC was described as the highest authority in an enterprise. And the Party committee was no longer a primary source of power in

⁴² Art.6.

⁴³ Especially Arts.5 and 6.

⁴⁴ Granick, supra note 23.

enterprise management. Even the director had to follow the instructions from and implement the decisions of the WSC. But a review of the trial implementation of that system suggested⁴⁵ that, worried about its potential negative effect, the central leadership did not encourage the large scale application of this system to many enterprises. In fact, this system quickly faded after 1985, though some enterprises, such as Shoudu Iron and Steel Company (as examined in our later discussion) have continued to apply this system.

C. The WSC system under the SEL

On September 15, 1986, in order to set up a new order following the introduction of the director responsibility system, the Central Committee of the CCP and the State Council jointly promulgated three sets of regulations respectively concerning directors, Party committees, and WSCs. Compared with the 1981 Provisional Regulations, the Regulations on the WSC in State Industrial Enterprises (hereafter "WSC Regulations") are more comprehensive. The WSC Regulations, which contain twenty nine articles and introduce several nominal and substantial changes, is still applicable today. Nevertheless, the SEL (1988) is more authoritative, and where the WSC Regulations do not conform to the SEL, the SEL shall prevail.⁴⁶

The SEL embodies a special chapter -- Chapter Five -- dealing with workers and the WSC. Six articles are included in

⁴⁵ Heath B. Chamberlain, "Party Management Relations in Chinese Industry: Some Political Dimensions of Economic Reform", China Quarterly 1987, pp.631-61, at 654-58.

⁴⁶ This is because the SEL is the formal law of the state, and the Regulations were promulgated as a policy document which has provisional nature. On Apr.28, 1988, the Central Committee of the CCP issued an Circular concerning the Implementation of the SEL. This Circular stated that the SEL and the Circular should be superior to all the previously promulgated documents which were not consistent with the SEL and the Circular. See the text of the Circular, in RMRB, May 11, 1988, pp.1 and 2. Also see Chapter Six of the thesis.

this chapter. Moreover, some other provisions of the SEL are also relevant.⁴⁷ In addition, Articles 49 and 50 concern the rights and duties of individual workers. Such provisions did not appear in either the 1981 Provisional Regulations or the 1986 WSC Regulations. They were not even included in the draft SEL published for the solicitation of opinions in January 1988. The rights of individual workers as provided in Article 49 are very widespread, ranging from participating in democratic management to labour protection, from suggestions on production to supervision of leaders. At the same time, Article 50 requires workers to work "with an attitude of being masters of the state" (zhurenweng de taidu), to observe labour discipline and enterprise rules and regulations. However, except for making the SEL more declarative, these provisions do not have much substantive influence on the functioning of the present enterprise leadership system. After all, the exercise of individual rights largely rests on the proper operation of the trade union and the WSC.

The SEL has downgraded the status of the WSC. The 1981 Provisional Regulations described the WSC as an "organ of power" (quanli jigou).⁴⁸ Such a declaration echoed the call for more powers to be accorded to the WSC. But, in fact, it also reflected the confusion about the role of the WSC in the years after the end of the Cultural Revolution. As discussed above, even under the trial system of director responsibility under the leadership of the WSC, only in exceptional cases was the supremacy of the WSC realised. Since 1985, in many enterprises, the WSC was no longer portrayed as the highest authority within an enterprise. Subsequently, a down-to-earth approach was taken in the 1986 WSC Regulations which describe the WSC as "the organ for the exercise of democratic management power by the workers" (zhigong xingshi minzhu quanli quanli de jigou).⁴⁹ This has also been confirmed by the

⁴⁷ Arts.8, 9, 10 and 46.

⁴⁸ Art.2.

⁴⁹ Art.3.

SEL.⁵⁰

The close link established in the 1950s between the WSC and the trade union has been maintained. The SEL provides that the working body of the WSC shall be the enterprise trade union committee.⁵¹ The WSC Regulations contain more detailed provisions on the work of the trade union committee. Article 23 lists a number of functions for the committee to perform. These include: to organise workers to elect workers' representatives; to propose subjects for the WSC to discuss; to preside at the joint meeting of heads of workers of workers' representative groups and heads of special groups to

⁵⁰ Art.51 provides: "the WSC is the basic form to realise the democratic management of enterprises, and is the organ for workers and staff to exercise their power of enterprise democratic management." It should be noted that in the SEL draft published for the solicitation of opinions, the word "right" rather than "power" was employed (see the text of that draft in Chinese, FZRB, Jan.11, 1988, p.2). "Right" (权利) and "power" (权力) have the same Mandarin pronunciation (quanli) and sometimes are confusing. But each word has a different meaning and different implications. For example, the National People's Congress is named as the highest organ of state "power" (Art.57 of the 1982 Constitution). Here in no way may "right" be used.

According to a law professor who suggested the change in the provisions of the draft SEL, democratic management is not a right, but a power. See Guan Huai, "Bixu Mingque Zhigong Zai Qiye Zhong de Zhurenweng Diwei -- Duiyu Wanshan Qiyefa de Yixie Jianyi" (The Master Status of Workers and Staff Must Be Clarified -- Some Suggestions Concerning the Draft SEL), GRRB, Jan.26, 1988, p.3. However, his argument for this is not convincing as he claimed that democratic management had little to do with the "interests" of workers and staff.

In fact, the distinctions between "right" and "power" in the Chinese context are far from easy to tell in many circumstances. As far as "democratic management" is concerned, the SEL uses both "right" (Art.49) and "power" (Art.51) to describe its legal nature. Moreover, the new Trade Union Law (supra note 21) also uses both "right" (Art.16) and "power" (Art.30) to describe the nature of the democratic management. For an interesting attempt to examine the nature of, and distinctions among "right", "power", and "functions and powers" (zhiquan), see Professor Shen Zongling, "Dui Hohfeld Falü Gainian de Bijiao Yanjiu" (Comparative Studies on Hohfeld's Theory of legal Concepts), Zhongguo Shehui Kexue (Social Sciences in China), No.1, 1990, pp.67-77.

⁵¹ Art.51.

conduct investigations and to do research, for the purpose of making suggestions to the WSC, examining and supervising the implementation of resolutions made by the WSC; to conduct propaganda and education on democratic management to workers; to organise workers' representatives to study policies, professional and management knowledge in order to improve their quality; to accept and handles complaints and suggestions made by workers' representatives; to protect legal rights and interests of workers' representatives; and to organise other work relating to enterprise democratic management. Thus, the enterprise trade union committee actually has the full control of the WSC.⁵² Moreover, the WSC Regulations provided that the superior trade union has the duty to "supervise, support and protect the WSC in correctly exercising its powers".⁵³ In addition, both the SEL⁵⁴ and the WSC Regulations⁵⁵ provide that workers' general assembly or workers' representative group may be organised at the level of workshop, to bring about democratic management. In such cases, appropriate meetings shall be organised by the trade union committees of the workshops.

What, then, are the "functions and powers" (zhiguan, hereinafter "powers") of the WSC? Article 52 of the SEL enumerates five categories of powers exercisable by the WSC:

(1) listening to and deliberating the factory director's report on the business policies of the enterprise, long term plans, annual plans, capital construction plans, plans for major technological reforms, training programmes for workers, plans for distributing and applying retained funds and plans in respect of the management responsibility system on a

⁵² Such control has also been confirmed by the Trade Union Law of 1992 (supra note 21). This new law, in Art.30, provides that a trade union committee is a working organ for the WSC; it is responsible for the day-to-day operation of the WSC, and shall check and supervise the implementation of resolutions adopted by the WSC.

⁵³ Art.24.

⁵⁴ Art.53.

⁵⁵ Art.25.

contractual or leasing basis and putting forward their opinions and proposals;

(2) approving or rejecting after examination enterprises wage adjustment plans, bonus distribution plans, labour protection measures, measures for awards and punishment and other major rules and regulations;

(3) examining and deciding on plans for the application of welfare funds for workers and for the distribution of house facilities to workers and other major issues concerning the welfare of workers;

(4) evaluating through discussion and supervising leading administrative cadres at all levels of the enterprise and putting forward proposals regarding their awards, punishment, appointment and removal;

(5) on the basis of decisions made by government departments in charge of the enterprise, electing factory director. and report the factory director-elect to the above departments for approval.

A comparison with the treatment in the 1981 Provisional Regulations⁵⁶ suggests that the basic structure of the powers of the WSC is similar in both the SEL and the Provisional Regulations, with the exception that the positions for categories two and three have been mutually exchanged.

The evolution from the 1981 Provisional Regulations to the 1988 SEL also indicates certain changes in the detailed powers enjoyed by the WSC. The contents in category one power of Article 52 of the SEL are powers exercised in the form of "listening to and deliberate" (tingqu he shenyi). Most objects of these powers had already appeared in the 1986 WSC Regulations. One additional object is concerned with the proposals on contracting or leasing responsibility system under which the enterprise is going to be operated. This was actually provided in category two (that is, the power to "deliberate and approve", shenyi tongyi) of the 1986 WSC Regulations. It was even contained in category two in the draft SEL published for the solicitation of opinions. However, by removing the above object from category two to one, the SEL alters the previous category two power by adding "or rejecting" (huozhe foujue) to the original "approving after examination" (shencha tongyi).

Despite the above noticed nominal degradation of the

⁵⁶ See Art.5.

power nature of the WSC, it is difficult to make any suggestion as to whether the SEL actually intends to reinforce or devalue the WSC. According to the 1981 Provisional Regulations, the WSC was entitled to "discuss and deliberate" and then "adopt relevant resolutions" on matters regarding enterprise management.⁵⁷ This provision would imply that, if such resolutions were to be binding, the WSC would possess real authority in relation to enterprise management. However, qualification was imposed in the 1986 WSC Regulations whereby any such resolution might only be adopted in the way "as to the implementation of the proposal considered". In contrast, as to the same matter, the SEL only authorises the WSC to "discuss and deliberate", and then "raise its opinions and make suggestions".⁵⁸ The wording regarding the effects of "adopting relevant resolutions" was completely dropped. Such an amendment might be best accounted for in two explanations. First, with the introduction of the director responsibility system, the power to command enterprise management had been gradually consolidated into the hands of the directors. The WSC may participate in discussions on enterprise management, but it is excluded from making any final decisions in this respect. Secondly, after the WSC was restored in 1979, it had been unable to fully carry out the powers relating to enterprise management as provided in 1981 Provisional Regulations. This was even the case, as discussed above, in those enterprises which experimented with the system of director responsibility under the leadership of the WSC. Therefore it would be more realistic for the law to adopt a down-to-earth approach in this regard. Actually, this category one power seems very similar to the right of consultation and information which is widely used in many Western countries.

Category two powers are those for the WSC to "approve or reject (veto)" matters on wage adjustment plans, bonus distribution plans, labour protection measures, measures for

⁵⁷ Art.5, par.1.

⁵⁸ Art.52, par.1.

awards and punishment, and other major rules and regulations. Obviously, these matters are all directly concerned with the interests of the workers.

As far as workers' welfare is concerned, the WSC is authorized to "decide" (jueding) after examination. This is the category three power. The power to decide living welfare matters is deliberately distinguished from the power to "approve or reject" matters regarding other interests of the workers. However, the SEL itself does not provide for the distinction in nature between these two powers. One textbook on the SEL seeks to explain such difference. It states:

the decisions made by the WSC after examination in relation to welfare matters are immediately effective, no reconsideration by the WSC or arbitration by higher government authority shall take place even if the director is not satisfied; but in the case of veto by the WSC, if the director disagrees, he may ask the WSC to reconsider its veto or report the case to higher authority for arbitration.⁵⁹

This explanation appears in line with the intention of the legislators. However, this book does not go further to explain the consequences of an arbitration award made by a higher authority against the veto decision made by the WSC. It is thus unknown whether or not the WSC shall have the right to reconsider an arbitration award. It may be presumed that any decision made by a higher authority is final and binding. This presumption is primarily based on the intentional differentiation between the power to decide and that to veto or approve. Furthermore, Article 20 of the 1986 WSC Regulations provides that any intra vires **decision** made by the WSC shall not be amended without the approval of the WSC. This article only applies to the case where the WSC uses its power to "decide", rather than the power to "approve or veto after examination". In addition, Article 46 of the SEL also suggests that the director must carry out only those **decisions** legally made by the WSC.

⁵⁹ Gao Kemin, Chen Yonghua and Xiao Ping, Qiye Zhi Hun-- Zhonghua Renmin Gongheguo Guoying Gongye Qiye Fa (The Soul of Enterprises -- the SEL in the PRC), Sichuan People's Press 1988, p.168.

The powers of categories three and four are rather weak indeed. The WSC may "evaluate through discussion" (pingyi) and "supervise" (jiandu) leading administrative cadres at all levels of the enterprise and then put forward proposals regarding their rewards, punishment, appointment and removal, but a decision can only be made by the government departments in charge of the enterprise. Moreover, like the case in the 1981 Provisional Regulations, only under the arrangement of the government departments in charge of the enterprise may the WSC elect the enterprise director, and no election result is effective unless and until it is approved by the government.⁶⁰ Indeed, it is doubtful whether the election of a director, that has to be exercised under so many restrictions, may be called a legal "power" at all.

A word-by-word examination of the powers enjoyed by the WSC suggests nothing but pure legal provisions. In order to have a comprehensive view of the actual application of these legal powers, one has to look at how and to what extent these powers are carried out in individual enterprises. But before any practical examination can proceed, two general comments should be considered.

First, the five categories of power as provided for in Article 52 of the SEL represent varying degrees of authority. As a whole, these powers may be seen as a circle. The centre of this circle is the power to decide matters concerning the welfare interests of workers. The further from the centre point the power is, the weaker the weight of the power is. The hierarchy for relevant powers from relatively strong to relatively weak is: the power to approve or veto proposals on workers' interests other than living welfare; the power to listen to and deliberate proposals on enterprise management; the power to evaluate and supervise enterprise cadres. The weakest power, of course, is that to elect enterprise directors. This is because the WSC may be "legally" deprived of this power by the government departments in charge of the

⁶⁰ Art.52, par.5.

enterprise.

Secondly, while the 1981 Provisional Regulations put the WSC under the leadership of the Party committee, the 1986 WSC Regulations claims that the WSC shall accept the ideological and political leadership of the Party committee.⁶¹ This SEL provision may imply that the Party committee shall no longer intervene with the daily administration of the WSC. In the mid-1980s, such provision not only reflected the decreased authority of the Party committee in enterprise, but also accorded with the full application of the director responsibility system. In fact, both the WSC Regulations⁶² and the SEL⁶³ stress that the WSC shall support the director in exercising his power. The SEL even goes further by requiring the WSC to "educate workers to carry out the duties as provided in the SEL".⁶⁴ Indeed, after the director has commanded the full legal authority to manage the enterprise, as the above discussion (that is, category one power) shows, the WSC is kept further away from enterprise management.

III. Evaluation of the WSC System

A. Practical implementation

First, we should note that the WSC has not been established in every state enterprise. Neither the 1986 WSC Regulations nor the SEL explicitly provides for the enterprise scale required for the compulsory establishment of the WSC. It may therefore be presumed that every state enterprise must have its own WSC. In large enterprises, even workshops are required to set up workers' general assembly or other forms of meeting to realise "democratic management". But according to

⁶¹ Art.4.

⁶² Art.5.

⁶³ Art.54.

⁶⁴ Nevertheless, except Article 50 (mentioned earlier), it is unclear what duties the SEL has expressly provided.

a survey carried out by the Gaungzhou Federation of Trade Unions,⁶⁵ in 1986, 90.2 percent of "enterprise and institutional units" (qishiye danwei) in Guangzhou City, Guangdong Province, had set up the WSC. Until July 1989, more than three hundred units did not establish their WSCs.

Secondly, more problematic is the actual implementation of the powers provided in Article 52 of the SEL. In 1989, the All China Federation of Trade Unions conducted a comprehensive Survey based on paper questionnaire, seminars and an analysis of enterprise's economic activities. This Survey concerned 855 enterprises -- 146 large enterprises, 397 medium and 312 small enterprises. The results of the Survey were published in late 1990,⁶⁶ -- two years after the initial application of the SEL.

As far as the WSC is concerned, the five categories of powers were decomposed in the Survey into eighteen items. The result shows that the actual implementation of these eighteen items varies considerably from one to one. Of those eighteen items, eight were category one power, that is, the power "to listen to and deliberate". The implementation of these items is relatively reasonable. Of all the WSCs in surveyed enterprises, eighty-three per cent exercised such power on enterprise's business policy, eight-two per cent on enterprise's annual plans, seventy-three per cent on long term plan, sixty per cent on contracting or leasing plans, 57.8 per cent on capital construction plans, fifty-six per cent on major technical innovation, fifty-five per cent on workers' training programmes, and forty-five per cent on plans for distributing and applying enterprise's retained funds.

As for the power "to approve or veto", seven items were listed in the Survey. Of all the WSCs in the surveyed enterprises, seventy-two per cent had such power on their

⁶⁵ For the result of this survey, see Zhang Xihong, "Dui Weihe Zhigong Hefa Quanyi Qingkuang de Diaocha" (A Survey on the Situation of Protecting Workers' Legal Interests), JJGL, No.8, 1990, pp.43-4.

⁶⁶ "Guanyu Qiye Fa Guanche Luoshi Qingkuang de Diaocha Baogao" (A Survey Report on the Implementation of the SEL), JJGL, No.10, 1990, pp.24-7.

enterprise's major rules and regulations; seventy per cent over their enterprises' wage adjustment plans; 69.4 per cent over their enterprises' housing facilities distribution plans, 58.4 per cent over their enterprises' measures for awards and punishment; 57.5 per cent over their enterprises' welfare issues; 57.4 per cent over their enterprises' bonus plans; 45.4 per cent over their enterprise's labour protection measures.

In the Survey, only one item was included in the WSC's power to resolve and decide. This was concerned with the application of workers' welfare funds. But according to the SEL,⁶⁷ the WSC should also have the power to resolve and decide the issues of plans for the distribution of workers' housing facilities and other welfare issues. As already shown, these two matters were put in the Survey under the power to approve or veto rather than that to resolve and decide. The published results of the Survey did not mention the reasons for such change. The change might have been based on an inside document which simply ignored the legal provision of the SEL. The reason for this policy adjustment might also lie in the intentions of further reducing the WSC's powers to decide issues and of avoiding possible embarrassment in relation to such sensitive issues as the distribution of workers' housing facilities. Nevertheless, even after the removal of two items, the picture for the implementation of the power to resolute and decide is still gloomy. Only in forty-seven per cent of enterprises surveyed did the WSCs have the opportunity to decide the issue of application of enterprise welfare fund, and in another thirty-one enterprises, the WSCs had partially exercised such power.

The Survey also revealed that only in about half (53.4 per cent) of all enterprises were the WSCs able to use the power of evaluating and supervising leading cadres of their own enterprises. Even worse, however, is that the WSCs in only 16.5 per cent of surveyed enterprises had exercised the power

⁶⁷ Art.52, par.3.

to elect directors. Among all 855 enterprises surveyed, the directors of only forty-nine enterprises were selected by the WSCs. Although no further details are reported, the Survey does raise the question that no rules are available to be followed when a superior government department does not approve such election results. Furthermore, the overall picture is that an overwhelming majority of enterprise directors were either directly appointed (653 enterprises) or recruited after the process of selection (129 enterprises) by government authorities in charge of the enterprises concerned. According to the SEL,⁶⁸ before any such appointment or recruitment is made, government departments must consult with the representatives of workers. But the Survey showed that, in most cases, such consultation did not take place. Even if there was prior consultation, the opinions raised by workers' representatives' were not seriously considered.

Given that the central and official position of those in charge of this Survey and the relatively large scale of involvement, the Survey may be regarded as authoritative. Of course, the results would have been more valuable if the Survey had been conducted in a more accurate way. For example, we are not told about the criteria which were adopted for judging "application" or "implementation" (luoshi) of a concrete power? Or more precisely, in what way or ways was a specific power exercised? Different understandings of these issues would certainly present different answers to Survey questions. For example, as far as the power "to listen to and deliberate" enterprise director's report is concerned, a director may, as the law requires, report relevant issues to the WSC, but the result could be very different whether or not the WSC discusses the report in a serious way and then raises its opinions and suggestions to the director. It may also be very different whether or not the director pays due attention to the suggestions made by the WSC. Moreover, in relation to the power "to approve or veto", and indeed the power "to

⁶⁸ Art.44.

decide", the answers regarding the exercise by the WSC of these powers may differ considerably, depending on whether the WSC votes with its own will or simply acts as a robber stamp by completely endorsing all the proposals presented before them by their directors.

Despite the Survey's inaccuracies, one can still grasp some basic points on the basis of the Survey. Generally speaking, on the one hand, the situation seems to be better as regards to powers to "listen to and deliberate" directors' report, "to approve or reject", and "to evaluate and supervise" administrative cadres of the enterprises. In other words, it is in the areas where no final decision-making power falls with the WSC that the WSC may have the opportunity to execute its powers. On the other hand, other powers are in serious trouble. As far as the power "to resolve and decide" is concerned, the objects for the exercise of this power has been reduced in practice, if not in law. And with only one object left, the power is not exercised satisfactorily. In addition, the Survey showed that WSC's power to elect directors was rarely used. This power has been worsened by the compulsory procedure that the result of any such election must be approved by relevant government departments.

The Survey results showed a high degree of unanimity with earlier analysis of the role played by the WSCs in the years up to the mid 1980s. It is disappointing to notice that not all the WSCs in the surveyed enterprises had the opportunity to exercise even one of their weakest powers, that being the power to "listen to and deliberate". Yet, the power "to approve or veto" has been subject to more difficulties.

There are, of course, reports which suggest that the WSC may play a significant role. For example, according to one report, when a director submitted the draft measures for the adoption of "advanced labour composition" (laodong youhua zuhe)⁶⁹ to a meeting of group heads of workers'

⁶⁹ Advanced labour composition usually means that within an enterprise, workers and foremen are given the flexibility and freedom to reorganise themselves in order to have the best

representatives, those group heads thought that the conditions for the introduction of such measures were not yet mature, and suggested to postpone the proposed measures. Later, "the director accepted their opinions and as a result complaints from the masses were calmed down".⁷⁰ In another enterprise, the director claimed that he had persistently supported the WSC in fully exercising its functions and powers. For example, he accepted WSC's suggestions and opinions which were concerned with the protection of female workers, with his decision regarding loans, and with the allocation of housing facilities.⁷¹

These model cases suggest that the WSC may occasionally play its role. In fact, in China, the WSC has a long history of being described as a "welfare organisation". Indeed, the SEL authorises the WSC to resolve and decide three welfare issues: plans for the application of workers' welfare funds, plans for the distribution of workers', housing facilities, and other issues concerning workers' living welfare. But the survey moved two of the three objects into the weaker power to "approve or reject", therefore leaving just one object -- plans for the application of workers' welfare funds to be subject to the WSC's deliberation and decision. But the survey showed that only half of the WSCs had the opportunity to "resolve and decide" this single issue. The WSCs in a significant number of enterprises may be described as only an "affiliated organ to assist enterprise administrative departments to handle the issues of workers' welfare".⁷² In

teams to carry out work targets.

⁷⁰ Fan Guoxing, "Quanxin Quanyi Yikao Gongren JieJi, Shi 'Erqi' Laochang Yong Bao Qingchun" (Relying Whole Heartedly on Working Class, and Making an Old 'Erqi' Factory Ever Young) , JJGL, No.8, 1990, pp.44-6, at 45.

⁷¹ Hou Baoting, "Changzhang Yao Zuo Qiye Minzhu Guanli de Tuijingzhe He Shijianzhe" (A Director Should Become the Promoter and Practitioner of Enterprise Democratic Management), RMRB, May 29, 1992, p.5.

⁷² Zhang, supra note 65, p.43.

other words, the WSCs in many enterprises may not even act as independent welfare-deciding organs.

Welfare and other connected matters have for a long time been seen as the most important job assigned for the WSC. The main consideration for this particular kind of workers' participation lies in that the proper treatment of welfare matters will ease and dissolve potential conflicts and complaints among workers. Discussions by workers, and decisions made by the WSC on welfare issues will serve to add not only more fairness but also more authority for the implementation of welfare issues. However, it is one thing to acknowledge that workers must be invited to deliberate on welfare issues, and it is another whether the WSC may be further allowed to decide any such matter.

Despite the fact that the number of items which are listed into the agenda of the WSC has increased drastically during economic reforms, a distinction exists between issues which are directly connected with the workers' interests such as welfare, and those which are not. It is on the issues of the former category that the WSC can be more active. Concerns, however, may also be expressed by the WSC over the issues which are not or used to be regarded as not directly connected with workers' interests. In the light of new management responsibility system, particularly that on the basis of "contracting" (chengbao) -- a subject to be examined in Chapter Nine of the thesis, complaints arise that the WSC is often excluded from airing its views on both the way in which the new system is carried out and the way by which an enterprise director is selected. On the one hand, in practice, when a director is appointed or recruited by government departments, few WSCs are consulted with by the latter. The WSC is therefore effectively prevented from taking part in any such consultation process.

On the other hand, connected with this problem is whether or not workers may join their directors in taking the risk of contracting with the government. One of the current practice is the system of "contracting by all members of the

enterprise" (quanyuan chengbao). Strictly speaking, this system does not change the legal relationship between the government and state enterprises. This is because, according to the law,⁷³ the chengbao contract is in nature concluded between the state represented by government departments and relevant state enterprises as the contractors. However, some differences may still exist between quanyuan chengbao and changzhang chengbao (contracting by the director) in case of the failure by the enterprise to fulfil a contract. As for changzhang chengbao, it is the director, in addition to the enterprise concerned, who will be liable, administratively and financially, to government departments for such failure. But under quanyuan chengbao, all workers and staff personally share the risk together with their director as well as the enterprise. If the enterprise fails to carry out the contract, workers will usually have to pay to government departments the amount of money that was used in the first place as a kind of guarantee for concluding the chengbao contract.

In Chinese official view, quanyuan chengbao is a better system in that workers will play a more active role in carrying out enterprises' objectives. This is because this system can make workers to work harder by forcing them to realise that they share the risks with their directors. But a further question must be asked: given that workers take greater risks in this new system, are they (through the WSC) allowed the real powers, for example, to freely select their directors and to participate more in management? Clearly, no clear and definite answer can be drawn from the statements made by the government. While theoretically speaking workers should be assigned with a more important role in managing their enterprises, given the generally disappointing performance by the WSC system, it is still far from true that workers' participation in enterprise management has been given serious consideration in the new situation.

⁷³ Art.14 of the Chengbao Regulations. Also see Chapter Nine of the thesis..

B. An untypical case

Having described in general terms the disappointing implementation of the WSC system, it is helpful to pursue a case study for a deeper insight into the actual functioning of the WSC in individual enterprises. The following discussion focuses on worker's participation in Shoudu Iron and Steel Company (Shoudu Gangtie Gongsi, hereafter "SISC"). This study is based on the materials I collected both in the libraries and during my study visit to China in early 1992. The selection of this case does not mean that it is typical. On the contrary, practices of this company are far from representative. Nevertheless, it is due to its exceptional success as measured by Chinese official standards that this case has received the broadest publicity.⁷⁴ In my view, the study of this untypical case may not only enhance a general and critical understanding of the so-called "good" or "successful" functioning of workers' participation in enterprise management, but also help observers to detect the trend in the development of workers' participation in Chinese state enterprises in broader spectrum when these much celebrated and well publicized experiences are extended to and "learnt by" many other Chinese state enterprises in the future.

The SISC, located in the suburbs of Beijing, is a leading large-sized state enterprise with a workforce of more than 180,000 workers. In addition to its extraordinary size and strategic importance, the SISC has also made its name by successfully carrying out the contracting system which has contributed to significant improvements in its economic efficiency and profit turnover.⁷⁵

⁷⁴ For a report, see RMRB (overseas edn.), Dec.2, 1991, p.4. See a series of reports in GRRB, starting on Mar.16, 1992, p.1. Also see a series of reports in Beijing Review, issues of early 1992, especially the issue of Mar.16-22, 1992, pp.24-7.

⁷⁵ See the discussion of the contracting system in Chapter Nine of this thesis.

In implementing the WSC system, the SISC seems to be more radical than the existing framework established by the SEL. Notably, unlike the general and weak declaration in the 1986 WSC Regulations that the WSC is "the organ for the exercise of democratic management power by the workers",⁷⁶ the SISC has chosen to explicitly acknowledge that the WSC is the "supreme organ of power" within the enterprise. This position of the WSC is more in line with the provision in the 1981 Provisional Regulations as discussed earlier.

One of the most successful achievements for the WSC at the SISC is described as the full realisation of its decision-making power. The WSC which is held once a year is praised as being able to make final decisions on SISC's annual plans regarding production operation, technical innovation and new construction projects, personnel training, wages and bonus and social facilities.⁷⁷ Decisions are also taken by the WSC in relation to long-term plans, the plans for the contracting management, and many other matters. Moreover, the WSC in the SISC is authorised to elect a general manager who should implement the decisions made by the WSC, report his work to the WSC, and respond to inquiries made by the WSC. When the WSC is not in session, the general manager is required to perform his duties and functions under the supervision of the Factory Committee which, being elected by the WSC, is authorised to exercise the authority of the WSC. In addition, the WSC also elects an administration committee responsible for matters of well-being. This committee which is accountable to the WSC is entitled to discuss and decide issues concerning the livelihood and welfare of workers and staff of the SISC.

Workers at the SISC are regularly kept informed about the detailed operation of the company. The most important channel has been the company's weekly "Bulletin" (qingkuang tongbao),

⁷⁶ Art.3. Also see similar provision in Art.10, SEL.

⁷⁷ For a report of the long process (four months) of consultation and discussion concerning one annual plan before the final and formal meeting of the WSC, see Beijing Review, March.16-22, 1992, p.25.

which is dispatched to the workshop level and passed on to all workers. The contents of the Bulletin range from management and production to workers' welfare issues. On the other hand, workers may make suggestions to the management. Such suggestions must be expressly answered within five days. If a worker who made a suggestion does not agree to the reply he has received, he may have a discussion with the person who is responsible for that reply.

One unique feature concerning the "democratic management" at the SISC is reflected by the establishment of supervision committees at levels in the company and its subsidiaries. Such supervision committees are elected by the WSC at the corresponding levels. The responsibilities and authority of these supervision committees include the protection of workers' rights and interests as well as supervision over the performance of administrative cadres and the management of the company. Supervision committees also publish monthly Supervision Bulletins which contain reports regarding the detailed activities of the supervision committees and even sanctions taken by the supervision committees against specific factories or personnel.

In general, worker's participation at the SISC seems to suggest a somewhat vague idea of the so-called five types of rights of workers: right of decision-making, the right of information, the right to elect, the right of supervision, and "the right of autonomy in well-being" (shenghuo zizhiquan). Compared with the loose and unclear framework established by the SEL concerning workers' participation, the practices at the SISC reflect certain signs of progress. The most notable improvement is the formation of several important institutions and channels designed to facilitate the "democratic management of enterprise". The establishment of factory committee and supervision committees, and the publication of bulletins may contribute significantly to the realisation of worker's participation.

As indicated earlier, worker's participation at the SISC is not typical in the sense that the above generalised

practices are not popular among Chinese state enterprises. Indeed, the information available seems to put too much praise and too little criticism on the actual functioning of the system. Nevertheless, this untypical case may at least demonstrate that the realisation of workers' participation varies from enterprise to enterprise, depending on many factors such as institutional designs, and the openness of the management, and the cooperation between different institutions.⁷⁸ Furthermore, it is certainly true that under the general endorsement of so-called "democratic management", worker's participation can be better carried out. The bold assertion by the SISC that the WSC is "the supreme organ of power", whether or not it is fully realised, is an example of the possibilities that practices in individual enterprises may build on and even deviate from the law which, being too declarative and loose, has failed to clearly define the status and role of the WSC and to properly address the issues affecting the realisation of workers' participation in enterprise management. In fact, supervision committees have been formed by the WSC without any explicit support from relevant law. In this sense, relevant legal provisions are not binding norms, but mere guidance that can be surpassed and ignored.

C. Comparative analysis

As a rule, certain forms of workers' participation were and are legally guaranteed in almost every socialist country.⁷⁹ In some Western countries including the United

⁷⁸ The Party secretary and president of the factory management committee of the SISC, Mr Zhou Guanwu, is a famous figure in Chinese industrial circle. In particular, he has been praised by the authorities for his openness and close connection with workers.

⁷⁹ For a brief and comparative discussion of workers' participation in the USSR and Eastern European countries, see Hubert Izdebski, "Legal Aspects of Economic Reforms in Socialist Countries", in American Journal of Comparative Law, 1989, pp.703-52, at 723-26.

Kingdom, workers' participation has not been legally accepted as necessary. Nevertheless, many Western countries have adopted different mechanisms to facilitate workers' participation. For example, in France, an enterprise committee is required by law to be set up in any enterprise that employs more than fifty workers.

The German system for workers' participation and codetermination in enterprise management is perhaps the most advanced. This is not only because this system has a long history, but also because it is more detailed in procedural provisions. In addition, the legal literature on the German system is easily available. The following is a brief comparison of the Chinese and the German systems in regard to workers' participation.

In Germany, there are two kinds of workers' participation.⁸⁰ One is through the works council, and the other is workers' representation to the supervisory board.

According to German company law, in addition to a management board, a supervisory board must be established in every company. Employees can have elected representatives to sit in the supervisory board. The supervisory board has two basic functions: to elect the members of the management board and to supervise the management board's activities. As a result of special law,⁸¹ workers are even given access to join the management board in the industries of the mining and the iron and steel. But in Chinese state enterprises, there is no supervisory board to ensure workers representation. In addition, although Chinese law provides that workers' representatives may become members of the enterprise management committee, such provision makes little difference since the committee only acts as an organ to "assist the

⁸⁰ Manfred Weiss, Labour Law and Industrial Relations in the Federal Republic of Germany, Kluwer 1987, pp.149-83.

⁸¹ The Act on Workers' Representation in the Mining and the Iron and Steel Industries of 1951. See ibid. p.175.

director to decide important matters".⁸²

As far as German enterprises in the private sector are concerned, the Works Constitution Act of 1952 (amended in 1972) requires every plant which employs more than five workers to set up a works council to realise worker's participation and codetermination in enterprise management. A comparison between the works council in Germany and the WSC in China suggests at least the following points:

First, German Law provides more detailed treatment on the institution of the works council. The Works Constitution Act alone has more than one hundred articles. This act is also reinforced by many other important items of legislation, including the Election Regulations of the Works Council (1972) and the Workers Codetermination Act (1976). But in China, as mentioned above, the 1986 Regulations are neither detailed nor up to date. And the SEL only contains a few articles on the WSC. Although the Federations of Trade Unions at all levels and enterprises themselves may promulgate more detailed regulations for the operation of the WSC, many procedural and substantial matters are unclear.

Secondly, as far as the right of participation is concerned, there are many similarities between the German and Chinese systems. In Germany, the rights of the works councils cover social, personnel and economic matters.⁸³ The works council can expect information and consultation on many matters. It may also make decisions on some important matters. Under certain circumstances, enterprise management is required by law to reach a so-called "compromise of interests" with the works council.⁸⁴ The works council is also entitled to enforce "social plans" asking for compensation to be given to the workers affected by the decisions made by the management. However, in addition to those powers arising from the special situations of the country concerned (for example, in China,

⁸² Art.47, SEL.

⁸³ Supra note 80, p.167.

⁸⁴ Ibid.

the distribution of housing facilities), it is rather difficult to make any conclusion on which organ, the works council or the WSC, possesses more powers. It is even more difficult to compare the actual functioning of each organisation.

Thirdly, it is interesting to see that both the WSC and the works council are asked to cooperate in good faith with the management. In Germany, the law prohibits the Works Council from resorting to industrial action.⁸⁵ In China, the WSC is required by the SEL to support the director. Moreover, the Party committee, which is an important source of power within state enterprises, is able to exercise its influence over the activities of the WSC.

In addition, there is a close link between the organs for realising the workers' participation and the trade unions both in China and in Germany.⁸⁶ Despite their division of labour, the two organisations have great influence upon each other. However, the relationship between the WSC and the trade union is obviously closer. It is not only because the two are supposed to have similar interests, but also because the trade union is assigned as the working body for the WSC.

Finally, and most interestingly, German law provides in detail for the settlement of dispute between the works council and the management. The most important body is the arbitration committee. This consists of an equal number of members appointed by both the employer and the works council, and a neutral president who chairs the committee.⁸⁷ The committee can not only recommend proposals but also make binding decisions in some circumstances.⁸⁸ In contrast, Chinese law does not contain any express provision concerning dispute settlement. According to Article 8 of the 1986 WSC

⁸⁵ Ibid. p.160.

⁸⁶ Ibid., p.150.

⁸⁷ Ibid., p.162.

⁸⁸ Ibid., pp.167-68.

Regulations, when the WSC has different opinions as to the decision made by the director within his authority, the WSC can raise its opinions to the director, or it can report to the superior trade union. The SEL makes no reference to the settlement of any disputes. As discussed above, in the case of a veto decision made by the WSC (category two power), the director may ask a superior government authority to arbitrate. Whatever the practical solutions for disputes are, at least there is no neutral dispute settlement body at enterprise level which may expedite the realisation of worker's participation. After all, the whole area is still controversial. No doubt, the lack of proper body and procedure for the settlement of disputes may circumscribe the proper and continuous operation of the WSC system in China.

IV. Conclusion

The worker -- staff Congress (WSC) is regarded in China as an important institution in state enterprises. Indeed, this institution is also important for collective enterprises.⁸⁹ The primary significance of the WSC is its ideological and

⁸⁹ The importance of the WSC in state enterprises is more obvious when compared with the organisational treatment in other types of enterprises. For example, in a private enterprise, neither a WSC nor a workers' general assembly is required by law to be formed, though a trade union may play such a role as negotiating collective contracts (see Art.33 of the Provisional Regulations Concerning Private Enterprises). This is also the case for foreign investment enterprises in China.

In a rural collective enterprise, a WSC or a workers' general assembly may be organised "to raise opinions and make suggestions regarding enterprise management and operation, to evaluate and supervise the director and other managerial staff, and to protect legal interests of workers" (See Art.26, the Regulations Concerning Collective Enterprise in Rural Areas). But apart from this declaration, the workers' organisation in rural collective enterprises receives no more detailed legal provisions. However, for urban collective enterprises, either a worker -- staff assembly or a WSC should be established to exercise functions and powers similar to those assigned to the WSC in state enterprises. (See Arts.27-30, the Regulations Concerning Collective Enterprises in Cities and Towns).

political implications. The WSC is employed to ensure that workers -- "the owners of the state"⁹⁰ -- can participate in "democratic management" of state enterprises. It is mainly due to this ideological and political position that workers' participation in state enterprises, as a political phenomenon and legal issue, is not allowed to be challenged. Moreover, workers' participation is also seen as an important means for enhancing economic efficiency through workers' active and positive involvement in enterprise management.

What has not been made clear by existing law, however, is the extent and degree of authority which the WSC can enjoy. Despite many legal and policy declarations authorizing the WSC with a number of powers, the WSC has not gained any decisive authority in the management of Chinese state enterprises.

Still less clear is government's determination to let the WSC properly exercise its powers. First, various restrictions are imposed. This is particularly evident for the power of the WSC to elect enterprise directors. Secondly, neither dispute

⁹⁰ It should be noted that since the beginning of the economic reforms, workers' status in state enterprises has been facing a crisis. The overall trend is that fewer workers now feel that they are the "masters" of the state and state enterprises. According to a survey carried out by the All-China Trade Union Association in 1988, of the 210,000 workers involved in the survey, 36.6 per cent felt that they were not masters; 51.5 per cent felt that their master status in enterprises was not high; and only 11.9 per cent felt that they were the masters. According to another survey carried out in 1990 by the Shanghai Political Consultative Conference, of the workers in thirty-one state enterprises in Shanghai, only 2.82 per cent agreed that they were fully treated as masters; 29.06 per cent thought that they were from time to time treated as masters; in contrast, 25.04 percent did not feel any they were masters; 35.99 per cent felt that they were merely labourers in enterprises; and 6.27 per cent did not know what to say. For the information, see Shidai (Times), No.1, 1992, pp.2-3. To some extent, the decline of the status of workers in enterprises has been due to the implementation of the Contracting system which puts emphasis on the performance of enterprise managers. For a discussion on the contracting system, see Chapter Nine of the thesis. Workers' feeling about their status in state enterprises is likely to continue to decline with the further implementation of the labour reform which seeks to put workers at a more vulnerable positions for dismissal and sanctions.

settlement bodies nor proper procedures for dispute settlement are provided for in the law. Thirdly, in practice, a large number of the WSCs have failed to exercise the powers as provided by the law. Some enterprises have not yet set up their WSCs. Thus, the so-called "powers" would be better described as "targets" or "objectives" rather than actual powers and authority. The WSC may be forced to waive its "powers", or be restrained from exercising its "powers".

Throughout the history of the PRC, state enterprises have been controlled either by Party committees, or by the directors, or indeed by both of them. Except in very few circumstances, the overall control of enterprise management has never rested with the WSC. Nor has the WSC been able to operate as an effective check on enterprise management.

Many difficulties would, of course, have been present if the law had conferred upon the WSC many decisive powers regarding enterprise management. These difficulties would include the poor quality of workers and the possible delay in enterprise decision-making process. Moreover, the WSCs might misuse their powers. These negative aspects of the WSC system would have to be considered if the leadership would move to authorise the WSC with real powers. But it is doubtful whether these difficulties are the real threats to the proper operation of state enterprises.

As a matter of fact, several policy factors have in one way or another, affected the actual functioning of the WSC system. First, during post-Mao economic reforms, the shift of responsibility and authority within an enterprise has presented a problem for the WSC. Although the government and the Party have repeatedly promised to guarantee workers with the right of participation and have called upon them to take a positive part in the reforms, many people feel that it is difficult to reconcile the director responsibility system with the active role of the WSC. Indeed, the legal provision that the WSC should support the director in exercising his powers and authorities may be understood as implying the necessity for reducing the role of the WSC. It seems that this

difficulty is similar to that facing workers' representative conference which prevailed in the early 1950s.

Secondly, the unchallengeable socialist tenet that the state, the enterprises and the workers have unanimous interests may prevent the WSC from actively pursuing workers' own interests.⁹¹ If the exercise by the WSC of its powers is deemed to be uneconomic and contrary to the overriding policy of the state and government departments, then the operation of the WSC is put into question.⁹²

Thirdly, the WSCs in most enterprises are not properly institutionalised. As the WSC in an enterprise is usually held only once a year, it can perform very limited functions. In the absence of express legal requirement, the establishment by the WSC of special institutions enabling the realisation of workers' participation varies from enterprise to enterprise, adding uncertainty to workers' participation in individual cases.

Fourthly, the WSC does not have significant organisational independence. Both the WSC and its working body, that is, the enterprise trade union committee, are subject to close supervision by enterprise Party committee and the superior trade union organisations. Moreover, the WSC is overlooked by superior government authorities which, for example, may impede the resolutions made by the WSC. In addition, as a rule, the WSC is restrained by the director in

⁹¹ For a discussion of this aspect and the related difficulty in defining by law the "interest of enterprises", see Chapter Six of the thesis.

⁹² In fact, the Trade Union Law of 1992 explicitly provides that the trade union should protect at the same time both the interests of the whole nation and those of workers and staff. It follows that the interests of workers and staff may have to be sacrificed if they conflict with the national interests. Indeed, such conflicts are very common during economic reforms which necessarily affect the interests of enterprise workers.

financial, personnel arrangement and many other aspects.⁹³ Thus, the multiple control system makes the WSC a passive and purely responding organisation. Few WSCs are interested in seeking to defend their legitimate powers and to play a vigorous role in supervising enterprise management and administration.

Of course, lack of legal, detailed and systematic treatment of the WSC also causes confusion over the practical operations of the WSC. In fact, the existing SEL provisions concerning workers' participation are more a political and moral targets than legal obligations. Despite the repeated call for clear and concrete guidance, and some actions, to enforce workers' participation,⁹⁴ it seems that unless there are substantial policy changes and detailed guidance, the confusion concerning the WSC system is bound to continue.

⁹³ Although the SEL provides, in Art.62, that leading cadres of enterprises who abuse their powers and violate the lawful interests of workers may be subject to administrative sanctions, it is unlikely that a director can be sanctioned merely on the grounds that he has failed to promote worker's participation in enterprise management.

⁹⁴ There have been some local actions to enforce the powers of the WSCs. For example, the government of Xi'an City in Shanxi Province of Northwest China approved a Proposal Concerning the Strengthening of Enterprise Democratic Management, which was made by the City Trade Union Association. This Proposal provides that, responsible persons who reject correct criticism from workers' representatives, and retaliate these representatives, and who impede the performance by the WSCs of their functions shall be ordered by the government departments in charge of relevant enterprises to correct their behaviour within a fixed term. If they fail to do so, they shall, depend on the seriousness of their actions, be warned, circulated a notice of criticism, or dismissed from their administrative positions. In addition, government departments must not approve those proposals made unilaterally by enterprise directors which should have been deliberated by the WSCs, such as proposals concerning wages distribution and the implementation of the contracting system. For a report, see GRRB, Aug.6, 1992, p.1. Similar actions have also been taken in other cities including Beijing. Nevertheless, the effects of these actions should not be overestimated.

CHAPTER EIGHT

ENTERPRISE BANKRUPTCY LAW AND POLICY

This chapter discusses the liquidation, bankruptcy and reorganisation¹ of Chinese state enterprises. The Enterprise Bankruptcy Law of the PRC (hereafter the "EBL") was adopted on December 2, 1986 and came into effect on October 1, 1988. Immediately after its adoption, the EBL received much attention from many scholars throughout the world.² However, most of their discussions tend to explain the EBL as it is stipulated, and therefore fail to pay sufficient attention to the complicated social, economic and political background that had informed this law.

This chapter does not intend to detail all aspects of the EBL. Instead, it attempts to explore and explain broader and more substantial issues relating to the methods by which Chinese authorities deal with the liquidation and the reorganisation of enterprises. Indeed, it is impossible to

¹ "Reorganisation" in this discussion is used as a term possessing a broader meaning than just referring to the reorganisation or reconstruction procedure usually occurring as a part of company insolvency or bankruptcy in the West. It embraces not only legal bankruptcy procedures but also administrative consolidation and reorganisation of companies, including mergers, which may have no connection with any legal liquidation or bankruptcy procedure.

² See, for example, Henry R. Zheng, "Bankruptcy Law of the People's Republic of China -- Principle, Procedure and Practice", Vanderbilt Journal of Transnational Law, Vol.19, 1986, pp.683-732; Ta-Kuang Chang, "The Making of the Chinese Bankruptcy Law: A Study in the Chinese Legislative Process", Harvard International Law Journal, Vol.28, 1987, pp.333-72; M. Minor & K. Steven-Minor, "China's Emerging Bankruptcy Law", International Lawyer, 1988, pp.1217-26; Xiao Zhiyue, "China's Bankruptcy Law: Socialist in Characteristics, Capitalist in Methods?", Company Lawyer (London), No.3, 1989, pp.58-65.

understand the EBL without a proper comprehension of the past, as well as present-day, policies and practices in the liquidation and reorganisation of state enterprises.

This discussion begins with a review of the policies and practices regarding enterprise bankruptcy, liquidation and reorganisation between 1949 and the adoption of the EBL in 1986. The discussion then seeks to analyze the reasons for, and difficulties with, the introduction of the EBL. In addition, the basic principles and characteristics of the EBL are examined. The discussion then progresses to an assessment of the impact of and the limitations in the EBL, with particular reference to the consolidation of companies between 1988 and 1991. This chapter concludes with a general comment of the current policies concerning, and future prospects for, bankruptcy, liquidation and the reorganisation of PRC state enterprises.

I. Policies of Enterprise Bankruptcy and Reorganisation Before the Economic Reforms

China's first Bankruptcy Law was adopted by the Qing government on April 25, 1906. With sixty-nine articles, that Bankruptcy Law contained nine sections, namely, report of bankruptcy, election of directors, creditors' meeting, clearing of accounts, disposal of property, deliberate fraud, extension of liquidation period, request for cancelling a case, and supplementary provisions. However, as Mitrano explains, that law, which was repealed on December 2, 1907, "was not effective as technique, and not enforced as legislation".³ The most fundamental reason for such failure was that "both officials and businessmen alike were

³ Thomas Matrano, The Chinese Bankruptcy Law of 1906-1907: A Legislative Case History, paper reprinted from Monumenta Serica 1972-1973, Vol.XXX, Harvard Law School, Studies in East Asian Law: China No.25, pp.259-195, at 295.

insufficiently prepared to utilize it".⁴ In 1935, the Nationalist government promulgated a comprehensive Bankruptcy Law which, after amendments, is still applied in Taiwan.

A. Bankruptcy policies in the 1950s

The socialist bankruptcy policies and legislation in pre-1949 China are virtually untraceable. Even in the early period of the PRC, bankruptcy issues received only limited treatment. For example, both the Provisional Regulations on Private Enterprises of 1950 ("Provisional Regulations")⁵ and the subsequent Implementing Rules Concerning the Provisional Regulations ("Implementing Rules")⁶ merely gave some clues as to liquidation and bankruptcy of private enterprises. First, the legal definition of private enterprises indicated the extent of investors' liability in the event of enterprise insolvency and bankruptcy. For example, a shareholder of a company limited by shares was liable to the extent of the par value of shares he or she held.⁷ Secondly, the law allowed flexibility for all parties. For example, the winding up, liquidation and other items not provided in laws and regulations "shall be dealt with in accordance with 'usual practice' (tongli) and upon negotiations between relevant parties, providing that any such resolution does not conflict with state policies".⁸ Moreover, "the separate and unlimited liability of an unlimited liability shareholder only occurs

⁴ Ibid.

⁵ See the text in Chinese, in Siyiq Gongshangye de Shehui Zhuyi Gaizao Zhengce Faling Xuanbian (Selection of Policies, Laws and Regulations Concerning the Socialist Reform of Bourgeois Industries and Commerce), Vol.1 (1949-1952), Finance and Economy Press (Beijing) 1957, pp.66-71.

⁶ Promulgated in January 1951, by the Committee of Finance and Economy under the GAC. See the text in Chinese, ibid, pp.72-93.

⁷ Art.3, the Provisional Regulations, supra note 5.

⁸ Art.30, ibid.

when the property of his enterprise is not enough to pay all the debts of the enterprise."⁹ Thirdly, the Implementing Rules contained rules for the "closing down" (xieye) or "winding up" (qingsuan) of an enterprise.¹⁰ Although the listed grounds for the closing down or winding up of enterprises appear not to have included bankruptcy,¹¹ it was nevertheless provided that, in the process of liquidation caused by any of the stated grounds, when a liquidator found that the assets of an enterprise were not enough to pay all the debts, he should apply to the court which should then handle the case.¹²

In addition to these provisions, there were some administrative orders or judicial opinions. For example, on October 10, 1955, the Supreme Peoples' Court and the Ministry of Justice jointly issued an Opinion Concerning Two Problems in the Process of Paying Debts of Bankrupt Private Enterprises. The Opinion stated that workers' salaries were to be paid as a priority.¹³ However, in general, the legal treatment of bankruptcy or liquidation was far from sufficient to cope with various problems. In particular, few provisions were made to protect the interests of creditors.

In 1950, the Chinese authorities made it clear that the Provisional Regulations should be understood in the light of the official policy of encouraging and protecting private

⁹ Ibid.

¹⁰ Arts.15-22, supra note 6.

¹¹ Art.15, ibid. The three such grounds were: (1) the cause of the enterprise had accomplished or had not been able to be achieved; (2) the intention of a sole trader, the agreement of all partners, or the resolution of shareholders meeting; (3) the merger with another enterprise.

¹² Art.21 of the Implementing Rules, ibid.

¹³ Mentioned in Ke Shanfang and Pan Zhiheng, Pochanfa Gailun (Introduction to the Bankruptcy Law), Guangdong Higher Education Press 1988, p.23.

investment.¹⁴ Accordingly, any shift in government policies would signify changes in the legal treatment of private investors. From the mid-1950s, many private enterprises were ordered to be merged with state-funded enterprises to form "state-capitalist enterprises" (gongsi heying qiye).¹⁵ Before setting up such enterprises, the assets of private enterprises had to be evaluated and its debts had to be cleared up.

Due to the lack of detailed legal provisions, the debts issue of private enterprises was settled mostly under the guidance of state policies. On March 30, 1956, the State Council issued an Order Concerning the Principles for the Handling of Debts and Other Issues of Private Enterprises Participating in State-Capitalist Enterprises ("Order").¹⁶ The Order clearly stated that the debts between a private enterprise and public bodies, and between workers and private enterprise owners, should be "dealt with in a lenient way" (congkuan chuli). The purposes for doing so were officially described as to ensure that a former private enterprise owner would be able to hold certain amount of shares in a state-capitalist enterprise and, to avoid massive bankruptcy owing to heavy debts sustained by private enterprises.¹⁷ Therefore, for example, in regard to bank loans, a former private enterprise's loan which was not due at the time of entering a state-capitalist enterprise should be transferred as the loan of the new enterprise, though the loan which was due or overdue should be repaid by the private enterprise before it

¹⁴ See Xue Muqiao, "Siying Qiye Zanxing Tiaoli Qicao Jingguo Jiqi Shuomin", (Drafting Process of and Explanations Regarding the Provisional Regulations Concerning Private Enterprises, Dec.29, 1950), in supra note 5, pp.93-102 at 95. Also see Art.1 of the Provisional Regulations (supra note 5).

¹⁵ The State Administration Council, on Sept.2, 1954, promulgated "the Provisional Regulations Concerning State-Capitalist Industrial Enterprises". See the text in Chinese, ibid, Vol.2, pp.231-36.

¹⁶ See the text in Chinese, in Laws and Regulations of the PRC (Jan. - Jun. 1956), pp.287-89.

¹⁷ Ibid., p.287.

entered a state-capitalist enterprise. Moreover, the loan which a private enterprise had difficulties in repaying might be transferred to the state-capitalist enterprise to repay, or be transformed as shares held by the state in the newly established state-capitalist enterprise. In addition, any ^{penalties} imposed on a private enterprise for overdue loan might, if necessary, be reduced.¹⁸

These administrative policies constituted the basis for handling debt issues of private enterprises in the mid-1950s. By allowing flexibility and discretion, the government clearly aimed at avoiding bankruptcy problems. There were some indications that, in the mid-1950s, the courts were involved in hearing bankruptcy cases.¹⁹ But administrative orders proved to be more effective as many bankruptcy cases were only found in the process of enterprise administrative reorganisation. Many such cases were solved "privately" and without resorting to the court. Indeed, the court, given the lack of detailed legal guidance, might only decide cases by relying on state policies and government administrative orders.

In the 1950s, while private enterprises received limited legal treatment, state and public enterprises were hardly subject to any formal legal regulation. Instead, administrative measures played an active role in dealing with bankruptcy and reorganisation of state and public enterprises. After 1956, private enterprises ceased to operate in the PRC. From then on and until the early 1980s, little attempt was made in the legal regulation of bankruptcy and reorganisation of state enterprises. For example, the draft Working

¹⁸ Par.4, ibid.

¹⁹ On Jan.17, 1957, the Supreme Peoples' Court issued Replies Concerning Several Problems in the Payment of Debts in Bankruptcy Cases. Mentioned in Ke and Pan, supra note 13, p.23. Also see Art.21 of the Provisional Regulations, supra note 5.

Regulations on State Industrial Enterprises (1961)²⁰ concentrated on enterprise administration and operation, leaving alone the reorganisation of enterprises.

The complete absence of legal regulation, however, does not mean that enterprises were never insolvent. Nor does it imply that enterprises were never subject to reorganisation. As a matter of fact, many enterprises continued to operate in deficit. From time to time, some enterprises were ordered by government departments to be reorganised. The most popular forms of industrial reorganisation were guan (closing down), ting (suspension of operation), bing (amalgamation with another enterprise), and zhuan (change to the manufacture of other products). Such reorganisation could take place at any time, depending on government decisions.

B. Administrative reorganisations

In September 1961, the Central Committee of the CCP decided to "adjust, consolidate, enrich and improve" (tiaozheng, zhengdun, chongshi, tigao) the national economy.²¹ One of the main themes of this campaign was to implement the policy of guan, ting, bing and zhuan. Economic efficiency, production orientation and size of enterprises were listed as the main considerations explaining reasons for the adoption of different measures for different enterprises. For example, enterprises which were supposed to be closed down were mainly those which consumed large amounts of raw materials, which had high costs and made low quality products, which still sustained losses after adjustment, and which did not possess normal production conditions. Enterprises whose products were needed by the society, but nevertheless whose raw materials

²⁰ See the text in Chinese, in Selected Enterprise Laws and Regulations, pp.45-73.

²¹ See the Editor Committee of the Current China Series, Dangdai Zhongguo de Jingji Guanli (Economic Administration in Current China), Chinese Academy of Social Sciences Press (Beijing) 1985, pp.61-6.

were temporarily short of supply, and whose production tasks were not full should amalgamate with other enterprises or reduce their production scale. Light industry enterprises which changed their production orientation during the Great Leap Forward (1958-1960) and such change had affected the supply of production or consumption goods should revive their previous production within a limited time. Enterprises whose production tasks were not full and which might be able to make products to help the agriculture, products of day-to-day consumption or machinery parts and spare parts should adjust the existing production orientation in view of the needs and possibilities. Furthermore, large-sized and key enterprises should be kept, with reduction and amalgamation made on medium and small-sized enterprises.²²

This massive industrial reorganisation must be examined from two aspects. First, it was aimed at adjusting the industrial structure. During the Great Leap Forward, a large number of factories were established without proper production facilities and conditions. Many of them were based on heavy industries, especially iron and steel. The production of many enterprises was neither practical nor necessary for the Chinese situation at that time. As such, the industrial reorganisation in the early 1960s served as a necessary measure for the adjustment of the national economy. According to the statistics published by the State Planning Commission, from 1961 to October 1962, as a result of the reorganisation, the number of industrial enterprises above the county level was reduced by 44,000. And the number of workers was reduced by 9,660,000.²³ Secondly, the industrial reorganisation was in essence a type of purely administrative measure. In spite of the absence of legal provisions, government documents

²² For a listing of these concrete criteria, see Tang Guodong, Gongye Qiyefa Gailun (Introduction to Industrial Enterprise Law), Chinese People's University Press (Beijing) 1987, p.180.

²³ See ibid. Most of the reduced workers were previously farmers.

provided little guidance for solving issues including bankruptcy. In fact, since virtually all enterprises were state-owned, the government might easily cancel or reduce the debts of an enterprise, or order the transfer of debts from one enterprise to another. Workers of enterprises being closed down were assigned with new jobs. In the case of a merger, workers were automatically transferred to a new enterprise. Consequently, there was no room, and little demand, for legal provisions regarding bankruptcy.

In 1979, in order to "adjust, reform, consolidate and improve" (tiaozheng, gaige, zhengdun, tigao) the national economy, the Chinese government decided to launch another massive reorganisation of industries. From 1981 to 1983, the main targets of the campaign were small enterprises, especially those whose products were not popular with customers, which competed with large enterprises for raw materials, and which were economically inefficient.²⁴ In October 1982, the State Council ordered relevant central and local government departments to make plans and carry out enterprise reorganisation. Among the first enterprises subject to guan, ting, bing and zhuan were, enterprise which consumed large amounts of raw materials, made low quality products, and sustained losses for a long time because of poor management; enterprises which produced more products than the society needed and, as a result, had overstocking of products; and backward enterprises which competed with advanced enterprises for energy, raw materials, transportation facilities and the market. In addition, enterprises which had sustained serious losses because of poor management had to make profits within a fixed term. Otherwise, they had to suspend their production and go through consolidation.²⁵

²⁴ See Zhongguo Qiye Guanli Baike Quanshu (Encyclopedia on Enterprise Administration in China), Enterprise Administration Press (Beijing) 1984, Vol.1, p.198.

²⁵ See Zhao Ziyang, Guanyu Diliuge Wunian Jihua de Baogao (Report on the Sixth Five-Year Plan), Peoples' Press (Beijing) 1982, p.38.

This industrial reorganisation took place on the eve of the Chinese urban economic reforms which formally started in 1984. The aims of that reorganisation were described as to change the unreasonable industrial structure and to improve backward enterprise management.²⁶ The inappropriateness of the enterprise structure was mainly judged by the unreasonably large number of industrial enterprises, which almost doubled in the decade from 1971 to 1980.²⁷ Since many of these enterprises were formed by various government authorities which paid little attention to either the need of the society or the production capability of enterprises, high costs and low product quality were common. Moreover, a large number of enterprises suffered serious losses because of low economic efficiency and defective management. Some even did not have independent accounting. About thirty per cent of state industrial enterprises which had independent accounting were actually operating at losses.²⁸

Like the previous industrial reorganisation of the early 1960s, this adjustment was also a kind of exclusively administrative measure. The State Council required every region and every government department to make two-year adjustment plans. These plans should include the lists of enterprises to be subject to guan, ting, bing and zhuan, as well as the implementing steps for the adjustment.

On April 1, 1983, the State Council promulgated Provisional Regulations Concerning State Industrial Enterprises ("Enterprise Regulations").²⁹ According to the Enterprise Regulations,³⁰ enterprise reorganisation could take six forms which included fen (separation of operation) and

²⁶ Ibid. p.37.

²⁷ Ibid. p.36. In 1970, there were 195,000 industrial enterprises. But in 1980, the number was 377,000.

²⁸ Ibid. p.37.

²⁹ See the text in Chinese, in Laws and Regulations of the PRC (Jan. - Dec. 1983), pp.383-99.

³⁰ Art.20.

gian (migration of operation) in addition to guan, ting, bing and zhuan. Any decision regarding the reorganisation of an enterprise was to be either made by the government department or departments which formerly approved the formation of the enterprise, or approved by these governments at the request of the enterprise. The Enterprise Regulations also expressly singled out seven grounds upon which decisions could be taken to reorganise enterprises. These included: where an enterprise's products could not be sold out for a long time; where an enterprise, because of its backward technology and low economic efficiency, did not have a prosperous future; and where an enterprise under poor management could not make obvious progress and suffered losses for two consecutive years. In addition, a decision to the effects of guan, ting, bing, fen, zhuan, and gian might be made "if the state considers it to be necessary."³¹ In any event, the state property in enterprises should be properly protected. Responsible government departments should supervise and check the disposal of such property. Workers of enterprises affected by government decisions should be allocated new jobs under the auspices of responsible government departments and local labour and personnel bureaux. In particular, whether to preserve, alter, or rescind contracts concerning, and debts on the part of, an enterprise being closed down was a question to be decided by the government departments in charge of the enterprise in accordance with relevant state provisions.³² Finally, the results of the reorganisation should be reported to the ABIC and other relevant government departments.³³

These formal legal provisions, however, were still too elementary to resolve the various issues arising from the reorganisation of enterprises. They were in fact no more than a pure recognition and formalisation of the then existing administrative practices. Government departments were

³¹ Art.20, par.8.

³² Art.21.

³³ Art.22.

authorised with exclusive powers to make decisions on and supervise the reorganisation of enterprises.

Among the various grounds which might trigger guan, ting, bing, fen, zhuan, or qian, many were directed at, or implied, the actual insolvency of enterprises. These included particularly where an enterprise suffered "losses" (kuisun) for a long time, and where an enterprise underwent low economic efficiency. Nevertheless, neither "insolvency" nor "bankruptcy" was expressly employed in the provisions of the Enterprise Regulations of 1983 as conditions for enterprise reorganisation. Indeed, such intentional avoidance reflected the traditional socialist hostility towards bankruptcy.

In the orthodox socialist view, bankruptcy could only take place in a capitalist society. Many official explanations were given for this "special" phenomenon. For example, in a capitalist economy, bankruptcy was a necessary result from "blind" (mangmu) market competition. Since the socialist system was a planned economy, enterprise production should be carried out under the guidance of state plans, and the relationship between enterprises should be cooperation rather than competition. Moreover, bankruptcy in capitalist countries may cause massive unemployment and therefore jeopardize the interests of workers. In contrast, a socialist state should guarantee the living of workers by securing their employment. Consequently, bankruptcy was seen as a phenomenon alien to the socialist economy.

It is true, however, that the adoption of the bankruptcy policy was not excluded by all socialist countries. For example, as early as 1965, Yugoslavia introduced the Law on Compulsory Clearing Up and Bankruptcy. And in Poland, a law relating to the bankruptcy of state enterprises was adopted in 1983. But generally speaking, until the mid-1980s, in socialist states, the bankruptcy policy was not commonly favoured and was only cautiously implemented in a few countries -- eventually on only a limited scale.

II. Introduction of the EBL

A. Reforms and legal development in the early and mid-1980s

The deficiencies of dealing with enterprise reorganisation in exclusively administrative methods became apparent immediately after the commencement of the post-Mao reforms. In 1982, about a quarter of Chinese state industrial enterprises were operating at losses.³⁴ Many of them were actually insolvent. This alarming fact posed at least two serious issues. First, since it was the government that finally bore the financial liabilities for all enterprises, such liabilities were obviously a heavy burden for the government. Every year, government financial departments had to provide a large amount of subsidies to enterprises making losses. When an enterprise was closed down because of heavy losses, the government had to either transfer or cancel all outstanding debts of the enterprise. As such, the government was actually bearing unlimited liability for all state enterprises. Secondly, and more importantly, enterprises faced little pressure and as a result had no incentive in pursuing economic efficiency. Enterprises making losses could obtain subsidies from the government. Workers of an enterprise being closed due to poor management could get salaries as usual³⁵ and could expect new jobs. Managers of such enterprises were usually transferred to other units to take administrative positions comparable to the previous one, or might even be promoted. Little responsibility might be invoked for loss-making enterprises and their managers.

The economic and legal developments since 1978 provided good opportunities for the introduction of a bankruptcy law in China. First, competition between enterprises was no longer forbidden. In October 1980, the State Council promulgated

³⁴ See Zhao, supra note 26.

³⁵ In order to pay normal salaries to workers, some closed enterprises were forced to sell out their property.

Interim Provisions Concerning Promoting and Protecting Socialist Competition.³⁶ As a result, inefficient enterprises were likely to be eliminated through competition. Secondly, various forms of responsibility system were introduced and applied to state enterprises in order to make them operate more efficiently. The state would in principle cease to give subsidies to enterprises making losses. In particular, the new taxation system launched since 1983 required all state enterprises to be subject to compulsory taxation.³⁷ As for an enterprise which made losses due to defective management, government departments should instruct it to reconstruct within a fixed term. During this term, government financial departments might offer to provide certain amount of subsidy. But once the term expired, no subsidy should be made to the enterprise.³⁸ Thirdly, and most significantly from the legal point of view, the development of the legal person system made it possible for a bankruptcy law to be introduced.³⁹ As a legal person, a state enterprise can and should bear independent civil liability. The state is no longer responsible for the debts of a state enterprise which shall be financially responsible to the extent of the total assets authorised by the state to manage.

B. Difficulties in adopting the EBL

The process of introducing the EBL, however, turned out

³⁶ See the text in Chinese, in Laws and Regulations of the PRC (1980), pp.35-8.

³⁷ For a discussion of the tax reform, see Chapter Five of this thesis.

³⁸ See "Caizhengbu Guanyu Guoying Qiye Ligaishui Shixing Banfa" (The Ministry of Finance, as approved by the State Council on Apr.24, 1983, Trial Measures Concerning The Conversion of Profit Payments into Taxation in State Enterprises). See the text in Chinese, in Laws and Regulations of the PRC (1983), pp.132-37.

³⁹ For the development and relevant problems, see Chapter Three of this thesis.

to be rather complicated and controversial.⁴⁰ Although the idea of enterprise bankruptcy appeared in China as early as 1980,⁴¹ this was not taken seriously until May 1984 when several deputies of the NPC made a proposal for drafting an enterprise bankruptcy law. From then on, rapid progress was made in relation to the implementation of bankruptcy policy in China.

In November 1984, a popular Chinese law magazine published a draft bankruptcy and reorganisation law proposed by an individual.⁴² Although this suggested draft law merely contained fourteen articles, this unprecedented move in the Chinese legal history which clearly advocated the adoption of a bankruptcy law attracted a wide range of attention from all works of Chinese society. Shortly after this move, in December 1984, the State Council decided to set up a special group to take a formal and official step in drafting a bankruptcy law.⁴³

Some local government authorities were even more active in adopting bankruptcy regulations in order to force enterprises to perform better. In February 1985, the Shenyang City Government, in Liaoning Province of Northeast China,

⁴⁰ For a comprehensive review and chronological survey of this process, see Chang, supra note 2.

⁴¹ Cited in Cao Siyuan, Tantan Qiye Pochanfa (Discussions on Enterprise Bankruptcy Law), China's Economy Press (Beijing) 1987, p.13. (Cao was assigned to be in charge of the drafting of the Chinese Bankruptcy Law.) However, the author who was cited here seemed to be talking about insurance companies only. And "daobi" (closing down), rather than "pochan" (bankruptcy), was used to describe the situation arising from insolvency. Nevertheless, some of the problems for dealing with bankruptcy, including compulsory insurance, were discussed.

⁴² See Cao Siyuan, "Zengqiang Qiye Huoli de Falü Cuoshi - -Guanyu Zhiding Qiye Pochan Zhengdun Fa de Jianyi" (Legal Measure For Enhancing Enterprise Vitality -- On the Suggestion for Enacting the Enterprise Bankruptcy and Reconstruction Law), in MZYFZ, No.11, 1984, pp.7-9. And the suggested Bankruptcy and Reconstruction Law was published in pp.10-11.

⁴³ See Chang, supra note 2, pp.339-40.

promulgated Trial Provisions Concerning the Handling of the Bankruptcy and Closing Down of Urban Collective Industrial Enterprises ("Shenyang Provisions").⁴⁴ The Shenyang Provisions may be listed, with some hesitation,⁴⁵ as the first bankruptcy law in the legal history of the PRC. With twenty-four articles, the Shenyang Provisions apply to collective enterprises only. On August 3, 1985, the Shenyang City Government declared that three collective Enterprises were to be "reconstructed" (zhengdun) for one year, as a warning and the first step of entering bankruptcy procedure as provided in the Shenyang Provisions. One year later, one of these three enterprises was declared bankrupt.⁴⁶ More interestingly, even before this, on June 21, 1985, the Wuhan City Government, of Hubei Province in central China, in the absence of any applicable law,⁴⁷ declared a state enterprise to be "on the verge of bankruptcy" (binlin pochan) and required it to be reconstructed.

At the national level, however, the adoption of the EBL met considerable opposition from the very beginning. In June 1986, the draft EBL was presented by the State Council to the NPC Standing Committee for deliberation. However, because of

⁴⁴ See Chang, supra note 2, p.341. On May 23, 1987, the Shenyang City Government issued new Interim Provisions Concerning the Closing Down and Bankruptcy of Urban Collective Enterprises which replaced the old Shenyang Provisions. See the text of the new Provisions in Chinese, in Zuixin Jingji Faui (The Newest Economic Legislation), Engineering Industry Press (Beijing) 1988, Vol.7, pp.353-60.

⁴⁵ It is debateable in China, whether "provisions" (guiding) issued by a city government can be called "law" (fa).

⁴⁶ For a study on this case, see Henry Zheng, China's Civil and Commercial Law, Butterworths 1988, pp.184-88.

⁴⁷ It seems that the decision was taken by referring to the suggested Bankruptcy and Reconstruction Law drafted by Cao Siyuan, supra note 42. On Dec.4, 1986 -- two days after the adoption of the national Bankruptcy Law, the Wuhan City Government issued Trial Provisions Concerning the Reconstruction Within a Fixed Term of State Industrial Enterprises ("Wuhan Provisions"). See the text in Chinese, in Zuixin Jingji Faui, supra note 44, Vol.6, pp.365-68.

the notable opposition, the EBL was delayed for three months until its adoption in December 1986.

Opponents of the EBL raised many issues in order to dismiss the condition for introducing the EBL as "not mature" (bu chengshu). One of these issues was the fact that enterprises did not have sufficient autonomy. Since many unfavourable outside conditions such as the irrational pricing policy forced many enterprises to make losses despite their endeavour to enhance economic efficiency, it appeared unfair to blame these enterprises and threaten them with bankruptcy. In addition, because of the tight government control, enterprises lacked the autonomy to make important decisions. Another issue raised by the opponents of the EBL was that China's social security system was not ready to cope with the unemployment problem caused by enterprise bankruptcy. It was warned that serious social problems would be present if a bankruptcy law was to be adopted and enforced.⁴⁸

For both proponents and opponents of the EBL, the debate represented not only a paradox but also a dilemma. On the one hand, most people agreed that enterprise reforms were extremely necessary. On the other hand, however, not everybody agreed on where and how to take the initiative in the reforms. For example, while few people doubted that enterprises should be given real autonomy, it was arguable whether an EBL should be introduced only after enterprises had obtained real autonomy, or the early introduction of the EBL could be used as a positive means for promoting and eventually realising enterprise autonomy. Similarly, as for the issue of the social security system, some people saw this as an issue to be dealt with in the implementation of the EBL, but others regarded the establishment of a proper social security system as a necessary pre-condition for the introduction of the EBL.

Proponents of the EBL made a number of efforts to help the adoption of the EBL. They even attempted to draw support from the people. The Chinese people, who did not know much

⁴⁸ See Chang, supra note 2, pp.368-70.

about bankruptcy and its consequences but nevertheless hoped for efficient enterprise management, showed their ambiguous support for the introduction of the EBL.⁴⁹

Most decisively, the central leadership was very keen to see an early adoption of the EBL. A number of measures were taken in order to pave the way for the adoption and implementation of the EBL. In particular, on July 12, 1986, the State Council promulgated four sets of Provisional Regulations.⁵⁰ In particular, the Provisional Regulations on the Insurance for Unemployed Workers and Staff in State Enterprises were aimed at establishing a social security system for unemployed workers. It was provided that the Provisional Regulations apply to, *inter alia*, workers of an enterprise which has been declared bankrupt, and workers and staff who are "dismissed" (*jingjian*) by an enterprise which is, because of being about to become bankrupt, being reconstructed for a fixed period of time.⁵¹ Moreover, on September 15, 1986, the State Council and the Central Committee of the CCP jointly issued three sets of regulations respectively concerning the director, the Party Committee, and the Workers/staff's Congress in state enterprises. These Regulations sought to establish a favourable environment for

⁴⁹ Different opinion polls showed different results. See Chang, *supra* note 2, pp.343-44. The fact might be that more than half of the Chinese workers were prepared to accept the fact of bankruptcy. In one such survey, when asked about "what would you do if your factory closed down or declared bankruptcy", fifty-one per cent answered as to "seek employment elsewhere", thirty-five per cent "try to open an individual business", ten per cent "go to the leadership for a settlement of the problem", and three per cent "do nothing but wait for the state to provide relief". See Reynolds (ed.), Reform in China (Challenges and Choices), M. E. Sharpe, Inc. (New York) 1987, p.157.

⁵⁰ They are respectively concerned with, Implementing Labour Contract System, Recruiting Workers, Dismissing Workers Violating Disciplines, Insurance for Unemployed Workers. See the text in Chinese, in Laws and Regulations of the PRC (1986), pp.775-93. See an English translation in Journal of Chinese Law, No.2, 1988.

⁵¹ Art.2.

enterprises' self-management. It was also implied that enterprises had to be completely responsible for their losses and debts.

After much debate and considerable controversy, in the light of great publicity,⁵² and under the persuasion of the central leadership, the NPC Standing Committee finally adopted the EBL on December 2, 1986. This was seen as a remarkable achievement in the building of the Chinese legal system and the reforming of the Chinese economic system.

Nevertheless, the adopted EBL is far from radical. While many detailed aspects of this law will be explored later, two general comments are considered at this stage.

First, the EBL only applies to state enterprises. The policy of adopting a bankruptcy law in China was formulated not only as a response to the "needs of the reform of the economic structure" as stipulated in Article 1 of the EBL, but as a compromise reached between opponents and proponents of the EBL. At first, a bankruptcy law was proposed to be applied to all types of enterprises, including collective enterprises and foreign investment enterprises. But after challenges from opponents, a compromise was reached to limit the scope of the EBL to state enterprises only.⁵³ In addition, the EBL is meant only "for trial implementation" (shixing).

By the mid-1980s, collective and foreign investment enterprises had developed rapidly in China. It was necessary to enact laws to regulate the closing down and bankruptcy of these enterprises. Before the adoption of the EBL, only a few pieces of legislation were applicable to enterprises other than state enterprises. For example, as for foreign investment enterprises, the only applicable regulations were the Regulations Concerning Bankruptcy of Foreign Related Companies in Shenzhen Special Economic Zone ("Shenzhen Regulations") which were adopted on November 29, 1986 -- just a few days

⁵² The EBL was passed with 101 affirmative votes and nine abstentions.

⁵³ See Chang, supra note 2, pp.361-64.

before the national EBL was passed.⁵⁴ And collective enterprises were only subject to a handful of local provisions, including above mentioned Shenyang Provisions. Nevertheless, in 1986, the jurisdiction of the EBL was restricted to state enterprises only. This fact reflected the Chinese leadership's caution towards bankruptcy policy.

Since the mid-1980s, the bankruptcy policy has come to be accepted more widely in the PRC. The amended Civil Procedural Law (1991),⁵⁵ which contains a chapter (Chapter Nineteen) on "Procedures for the repayment of Debts Owed by Bankruptcy Enterprise Legal Persons", is applicable to all enterprise legal persons other than state enterprises.⁵⁶ Therefore, collective enterprises, foreign investment enterprises, and even private enterprises, if qualified as Chinese legal persons, are within the jurisdiction of this Chapter. In addition to several procedural provisions, the Civil Procedure Law also stipulates for some substantial matters such as the bankruptcy test.⁵⁷

Secondly, notwithstanding considerable opposition, it took just two years from the formation of an official drafting team in December 1984 to the adoption of the EBL in December 1986. This legislative process was very short -- compared to a total of eight years that the SEL experienced.⁵⁸ When the

⁵⁴ Adopted by the Standing Committee of the Sixth Guangdong People's Congress, the Shenzhen Regulations were effective from Jul.1, 1987.

⁵⁵ Adopted by the Fourth Session of the Seventh NPC. Promulgated on, and effective from, Apr.9, 1991.

⁵⁶ Art.206 of the Law. Therefore, non-legal person entities are still out of the jurisdiction of this law.

⁵⁷ Art.199. The test is similar to the test adopted in the EBL, as discussed below.

⁵⁸ The SEL was deliberated and then adopted by the NPC. In contrast, the EBL was adopted by the NPC Standing Committee. According to the PRC Constitution, "basic laws" (jiben falü) are to be adopted by the NPC (Art.62), whereas the NPC Standing Committee may adopt "laws except those which are supposed to be enacted by the NPC" (Art.67). However, it is unclear in Chinese law what are the criteria to tell "basic

EBL was adopted, the SEL was still in the stage of drafting. Nevertheless, Article 43 of the EBL provided that the EBL would only be implemented three full months after the SEL came into effect. It is therefore obvious that the early adoption of the EBL was, by "putting the cart before the horse",⁵⁹ actually attempting to put pressures on the legislative process of the SEL.

The mere adoption of the EBL failed to resolve many difficult problems raised in the drafting of the EBL. The opponents of the EBL have never taken its implementation seriously. Nor can the proponents of the EBL. Indeed, many social, political as well as economic factors which underlined the difficulties for the promulgation of the EBL are still present ever since the coming into effect of the EBL on November 1, 1988.

III. Principles and Characteristics of the EBL

A. Tests of bankruptcy

In the process of deliberating the EBL, three general tests were suggested. They were ratio of liability to assets, ratio of losses to assets, and timely payment of debts.⁶⁰ However, the first two were dropped later. In fact, the differences between these two dropped tests were not substantial. While the test concerning the ratio of liabilities to assets was illustrated by a simple method of comparing the debts with property of an enterprise, the test concerning the ratio of losses to assets was expressed by a

laws" from other non-basic laws. Regardless of the underlying reasons why the EBL was treated differently from the SEL, it is apparent that the NPC Standing Committee, which meets much more often than the NPC, has the convenience and advantage of speeding up the process of deliberating and adopting laws, including the EBL.

⁵⁹ This was a criticism for the harsh adoption of the EBL. Mentioned in Xiao, supra note 2, p.65.

⁶⁰ See Chang, supra note 2, pp.358-59.

percentage between the "accumulated net losses" and, either the "productive capital", or "registered capital" of an enterprise.⁶¹ The connection between these two tests lied in that enterprises' debts usually resulted from losses.

The reason for the rejection of the ratio tests may be best explained from the viewpoint of reality rather than any theoretical rationale. In china, "assets" (caichan) and "capital" (zijin) are not strict and well-defined concepts. Since state enterprises are only give limited access to the public recruitment of capital,⁶² government departments must specify the amount of "registered capital" (zhuce zijin) of an enterprise. But some enterprises may never be able to take charge of the full amount of their registered capital. Instead, with the help of government departments, enterprises tend to rely on bank loans. In granting loans to state enterprises, state banks had to (and still do) pay great attention to the opinions and orders from the government departments in charge of enterprises. Thus many inefficient and even insolvent enterprises can obtain bank loans with little difficulty. Because of the heavy reliance on bank loans, a large number of state enterprises would fail any of the above ratio tests. The ratio tests, in the opinion of many people, would not serve the aim of forcing enterprises to make better performances, as these tests did not "directly reflect the operating conditions of enterprises".⁶³

On the other hand, even for those who wanted to change the practices described above, the ratio tests were also seen as inappropriate. However, they took a different approach, because they seemed to pay more attention to the "reputation"

⁶¹ See ibid. p.359. The idea concerning "productive capital" was suggested by Cao Siyuan in his proposal (supra note 42), while that concerning "registered capital" was raised by the Solicitation Draft of the EBL.

⁶² Except that, compared with collective and private enterprises, state enterprises have the privilege of issuing "debentures" (zhaiquan). See the discussion in Chapter Four of this thesis.

⁶³ Cited in Chang, supra note 2, p.359.

(xinyu) of an enterprise in question.⁶⁴ For example, even if an enterprise was insolvent according to the ratio tests, if it had a good reputation, it could still raise money, for example, through bank loans to repay outstanding debts.

The EBL is silent as to the meaning of "inability to repay debts that fall due".⁶⁵ One commentator suggests⁶⁶ that the ratio of liabilities to assets ("ratio test") adopted in the Shenzhen Regulations is "stricter" than the inability to repay debts ("inability test") adopted in the EBL. However, this view is unfounded. On the one hand, the ratio test does exclude the situation where an enterprise cannot repay debts merely because of a cash shortage, not because its liabilities have exceeded its assets. Thus, an enterprise which fails the inability test may nevertheless pass the ratio tests.⁶⁷ On the other hand, an enterprise which is caught by the ratio test may survive the inability test. This is precisely the principal reason, as explained above, why the ratio tests were dropped after consideration by the legislators of the EBL.

Furthermore, the deletion by the EBL of the ratio tests does not mean that the ratio tests are necessarily excluded from consideration by the court in judging whether an enterprise is bankrupt. Two reasons may be given for this. First, as a rule, the ratio of liabilities to assets must be considered as a matter of the very basic factor in assessing an enterprise's ability to repay its debts as they fall due. Other factors which must be looked at by the court include "reputation" and even various capabilities such as

⁶⁴ See Cao, supra note 41, p.25. Also see Tong Rou (ed.), Quanmin Suoyouzhì Gongye Qiyefa Gailun (Introduction to State Industrial Enterprise Law), Chongqing Press 1988, pp.268-69.

⁶⁵ Art.3. Such a definition is, for example, provided in S.123 of the British Insolvency Act (1986).

⁶⁶ See Zheng, China's Civil and Commercial Law, p.188. Also see Art.3 of the Shenzhen Regulations, supra note 54.

⁶⁷ See R.M. Goode, Principles of Corporate Insolvency Law, Sweet and Maxwell (London), 1990, pp.26-7, especially the "cash flow" test, as against the "balance sheet" test.

technologies possessed by an enterprise which might be used to help the enterprise to overcome temporary financial difficulties.⁶⁸ Secondly, the ratio of liabilities to assets may in some cases be used as the sufficient legal ground for declaring bankruptcy on an enterprise. These cases include, inter alia, where the debts of an enterprise significantly exceeds its assets, and where a debtor enterprise, upon the approval of its superior government departments, files a bankruptcy application. Indeed, the first reported bankruptcy case concerning a state industrial enterprise appeared to be decided by relying merely upon the grounds that the enterprise's "liabilities exceeded its assets" (zibu dizhai).⁶⁹

The Opinions Concerning Several Issues in Implementing the EBL (hereinafter "Bankruptcy Opinions"), issued by the Supreme People's Court on November 7, 1991, attempt to solve the confusion regarding the test for enterprise bankruptcy as provided in the EBL. Article 8 of the Bankruptcy Opinions provides that "the inability to repay debts" shall be understood as referring to the occurrence of the following situations: (1) the term for the repayment of the debts has expired; (2) the creditor has asked for the repayment of the debts and; and (3) the debtor obviously lacks the ability to repay the debts. It is further provided in this article that the "inability to repayment debts" may be presumed if the debtor has ceased to repay matured debts and the state of such stoppage has continued, and if no contrary evidence can be given.

To some extent, this provision helps to clarify the meaning of the inability test by declaring several requirements for the presumption of such inability. However,

⁶⁸ See Tong (ed.), supra note 64.

⁶⁹ For the report, see RMRB (Overseas edn.), Dec.7, 1989, p.1. The enterprise, called Nanchang Motor Factory, in Jiangxi Province, had accumulated losses of 5.26 million Yuan, and debts of 9.51 million Yuan, but it only had the assets of 4.67 million Yuan. The debtor enterprise itself filed the bankruptcy application.

this provision is not completely clear. For example, the criteria for assuming the debtor's "obvious" or "apparent" (mingxian) lack of ability to repay debts are unknown. It may still be very relevant, and indeed necessary, for the creditors as well as the judges to look into the underlying reasons accounting for the debtor's failure to repay its debts. For example, if the failure of a debtor enterprise to repay its debts is because it has a temporary shortage of cash, and not because its debts have substantially exceeded its assets, it may be protected by the court from being subject to bankruptcy proceedings. Another area of uncertainty is that the Bankruptcy Opinions do not clarify the period of time which, if the debtor does not repay its debts, may be counted in presuming the debtor's inability to repay such debts. In practice, disputes may arise as to the length of such a period. It is likely that great discretionary power may be given to the judges who may restrain creditors from requesting an earlier declaration of bankruptcy on the debtor enterprise. It is also likely that a debtor enterprise may take advantage of this ambiguity to delay genuine bankruptcy proceedings.

Despite the difficulties in defining the inability test, it is safe to conclude that, in terms of the economic considerations, the bankruptcy test adopted in the EBL does not necessarily contain significant differences from the tests in other bankruptcy rules such as the Shenzhen Regulations. This test is even similar to those adopted in many foreign jurisdictions.

In fact, the fundamental difference between the EBL bankruptcy test and other bankruptcy tests lies in the non-financial aspects. For the purposes of bring bankruptcy proceedings against a debtor enterprise, in addition to the proof that this enterprise is unable to repay debts that fall due, it is necessary to establish that the losses suffered by the debtor enterprise is attributable to its "inappropriate management and administration" (jingying quanli bushan).

As mentioned earlier, it is a fact that in China some

enterprises are never profitable because of various reasons that are simply beyond their own control. Indeed, the losses caused by the supply of materials, the unreasonable pricing and other factors which cannot be controlled by enterprises themselves are usually termed "policy losses" (zhengcexing kuisun), which contrasts with "losses due to defective management" (jingyingxing kuisun). The state used to, and still do, take it as a priority to provide subsidies to enterprises suffering "policy losses", in order to keep balances among enterprises.

Furthermore, Article 3 of the EBL explicitly lists as exemptions from any bankruptcy proceedings two types of enterprises. The first type refers to public utility enterprises and enterprises that have an important relationship with the national economy and the people's livelihood, for which the relevant government departments grant subsidies or adopt other measures to help the repayment of debts. The second type covers those enterprises that have obtained guarantees for the repayment of debts within six months from the date of the application for bankruptcy.

By putting limitations on both the tests for bankruptcy and the grounds for the prevention of bankruptcy proceedings, the Chinese government has shown its intention to minimise bankruptcy cases by preventing those bankruptcy proceedings that are deemed to be unnecessary and unfair. These qualifications serve to relieve people from being worried about the consequences arising from the otherwise frequent occurrence of bankruptcy. Such intention was confirmed by both an editorial of China's Legal News⁷⁰ and a person responsible for the Legislative Affair Committee under the NPC Standing Committee.⁷¹ It was assumed by the officials that bankruptcy

⁷⁰ "Fazhan Shehui Zhuyi Shangpin Jingji He Jingji Tizhi Gaige de Xuyao" (The Needs for Developing Socialist Commodity Economy and Reforming the Economic System), ZGFZB, Dec.3, 1986, p.1.

⁷¹ "Qiye Pochanfa Ye Shi Chujingfa" (The EBL is also an Enabling Law), ibid, Dec.5, 1986. pp.1 and 4 at 1. The person was, however, saying that bankruptcy cases "may be few".

cases following the promulgation of the EBL would be "few". Such a situation was regarded as ideal since the leadership did not want economic order and social stability to be affected by the implementation of the EBL.

These qualifications, however, may cause considerable controversy and uncertainty. First, the criteria for judging whether or not an enterprise is under "poor management and administration" is unclear. In particular, it is unknown whether an enterprises whose loss-making is only partly due to its "poor management and administration" can be made subject to bankruptcy proceedings. Secondly, the EBL does not define the coverage of "public utility enterprises" and "enterprises that have important relationship to the national economy and the people's livelihood". Even if the term "public utility enterprises" can be understood generally to embrace, for example, enterprises of transportation services, it is rather difficult to draw a line between enterprises that "have important relationship to the national economy and the people's livelihood" and those that do not. Thirdly, and most critically, the EBL does not indicate who, superior government departments in charge of enterprises or the courts, are entitled to make final judgments regarding the above problems. As will be discussed later, due to the potential conflicts of interests, government departments may choose to protect enterprises under their supervision and therefore make judgments in favour of the debtor enterprises. But the court, in adjudicating cases, may hold a different view after taking into account the interests of all relevant parties, including the creditors.

B. Dominant roles of government departments

Under the EBL, government departments, particularly those in charge of enterprises (qiye zhuquan bumen), play a significant role throughout the bankruptcy proceedings.

First, according to the EBL, a bankruptcy application may be filed either by an enterprise or its creditors. However, in

the case of a filing by a debtor enterprise, such application can only be made "upon the agreement of the superior departments in charge".⁷² Thus, an insolvent enterprise must not file for bankruptcy if its superior government departments do not agree. In many cases, inefficient enterprises have to continue its loss-making operation.

Secondly, where a debtor enterprise is unable to repay its debts that are due, the creditors may file for a declaration that the debtor enterprise is bankrupt.⁷³ However, as discussed earlier, creditors of the two listed types of enterprises are prevented from filing applications at all.⁷⁴ Moreover, if the enterprise's superior departments in charge have applied for reorganisation and if the enterprise and its creditors have reached a settlement through consultation, bankruptcy proceedings shall be suspended.⁷⁵

Reorganisation or reconstruction (zhengdun) presents a different picture from that which prevails in the West. This picture can only be understood in a broader spectrum. As illustrated earlier, the Chinese government used to reorganise enterprises through purely administrative, rather than legal, means. These practices continue until today. Government departments have the power and authority to make decisions concerning enterprise reorganisation, including guan, ting, bing and zhuan. It is against this background that the EBL only offers the reorganisation procedure to an enterprise for which the creditors apply for bankruptcy. The omitting of such procedure for an enterprise which itself applies for bankruptcy is therefore not a "drafting error", as some observers read.⁷⁶ In fact, the requirement that a debtor enterprise, before applying for bankruptcy, must obtain

⁷² Art.8.

⁷³ Art.7, par.1.

⁷⁴ Art.3, par.2.

⁷⁵ Art.3, par.3.

⁷⁶ Minor and Steven-Minor, supra note 2, p.1220.

consent from the superior government departments in charge, implies that these government departments may, instead of allowing an enterprise to resort to bankruptcy procedure, choose to "save" the enterprise by putting it under administrative reorganisation carried out exclusively by the department.

According to the EBL, with respect to an enterprise whose creditors apply for its bankruptcy, the superior departments in charge of this enterprise may, within three months after the people's court has accepted the case, apply to carry out reorganisation of the enterprise; the period of reorganisation shall not exceed two years.⁷⁷ Moreover, the reorganisation of the enterprise shall be "supervised" (zhuchi) by the superior departments in charge.⁷⁸ Of course, the court can keep an eye on the reorganisation process. For example, the court may terminate reorganisation and declare bankruptcy on an enterprise if the enterprise does not implement the settlement agreement reached between the enterprise and its creditors.⁷⁹

The provisions of the reorganisation procedure is aimed at saving enterprises as far as possible from going into bankruptcy. Similar provisions may also be found in the Shenzhen Regulations. It is, however, largely unknown what impact these provisions have on the bankruptcy proceeding. One danger might be that creditors are persuaded or even forced by the government departments in charge of a debtor enterprise to reach an agreements with the debtor enterprise. This may be the case especially where both the debtor enterprise and the creditors are under the supervision of the same government department. It follows that bankruptcy proceedings might be delayed unreasonably for a considerable period of time, therefore damaging the interests of creditors.

Thirdly, Chapter Five of the EBL, which concerns bankruptcy declaration and bankruptcy liquidation, is placed

⁷⁷ Art.17.

⁷⁸ Art.20.

⁷⁹ Art.21.

after Chapter Four regarding settlement and reorganisation. This arrangement contrasts with that in the Shenzhen Regulations where "reconciliation" (Chapter Five) falls after "liquidation" (Chapter Three). According to Article 24 of the EBL, a liquidation team shall be established by the court "within fifteen days after the date the enterprise is declared bankrupt". While in the case of the Shenzhen Regulations, a liquidation committee must be formed by the court "within ten days after the court decided to hear the case".⁸⁰ The nominal difference between the two provisions is that, in a bankruptcy case relating to a state enterprise, no liquidation team shall exist before an enterprise is actually declared by the court to be bankrupt.⁸¹ A significant difference may, however, be drawn in that, as shown above, the reconstruction procedure for state enterprise cases is dominated by the government departments in charge of the debtor enterprises concerned. Although the court could exercise a check on such reorganisation, a liquidation team is nevertheless kept away from any kind of supervision which would be carried out by a liquidation committee formed in accordance with the Shenzhen Regulations.⁸²

Under both the EBL and the Shenzhen Regulations, members of a liquidation team or committee must be appointed by the court hearing the case. Apart from requesting that a liquidation committee which shall consist of three to five members must include an accountant registered in China,⁸³ the Shenzhen Regulations are silent as to who else is eligible to be appointed as a liquidator. In contrast, the EBL, though not specifying a required number for a liquidation team, does instruct the court to make appointments from "the superior government departments in charge of the bankrupt enterprise,

⁸⁰ Art.12.

⁸¹ See Zheng, China's Civil and Commercial Law, p.195.

⁸² See, for example, Arts.14(4) and 20 of the Shenzhen Regulations.

⁸³ Art.12 of the Shenzhen Regulations.

government financial departments and other relevant departments", as well as from professionals.⁸⁴ Thus, like the case in enterprise reorganisation,⁸⁵ government departments are authorised to play an important, possibly dominant, role in the liquidation of bankrupt enterprises.

A liquidation team shall take over the administration of the bankrupt enterprise. It shall be responsible for the keeping, putting into order, appraisal, disposition and distribution of the bankruptcy property. The liquidation team may carry out necessary civil activities in accordance with the law.⁸⁶ The debtors of a bankrupt enterprise and persons holding the property of a bankrupt enterprise can repay debts or deliver property only to the liquidation team.⁸⁷ The liquidation team may also decide to terminate or to continue to perform the contracts that have not yet been performed by the bankrupt enterprise.⁸⁸

The EBL provides detailed guidance for the composition and the distribution of bankruptcy property. Bankruptcy property comprises: (1) all property that the bankrupt enterprise managed and administered at the time bankruptcy was declared; (2) property obtained by the bankrupt enterprise during the period from the declaration of bankruptcy until the conclusion of the bankruptcy proceedings; and (3) other property rights that the bankrupt enterprise should

⁸⁴ Art.24, par.2, EBL.

⁸⁵ In that case, however, governments are supposed to "preside" (Art.20, par.1).

⁸⁶ Art.24, par.1, EBL.

⁸⁷ Art.25, par.1.

⁸⁸ Art.27, par.2. If the liquidation team decides to terminate a contract and the other party to the contract suffers harm as a result of the termination of the contract,, the amount of compensation for the harm constitutes a bankruptcy claim. See Art.26, par.2. Compare with Art.34, par.3 of the Shenzhen Regulations where such harm is denied compensation.

exercise.⁸⁹ During the period from six months before the court accepts the bankruptcy case until the date that bankruptcy is declared, some actions of a bankrupt enterprise are null and void. These actions include: (1) concealment, secret distribution or transfers of property without compensation; (2) sale of property at abnormally depressed prices; (3) securing with property claims that originally were not secured with property; (4) early repayment of claims that are not due; and (5) abandonment of the enterprise's own claims.⁹⁰ Consequently, in any of these cases, the liquidation team is entitled to apply to the court to recover the property, which shall be added to the bankruptcy property.⁹¹ In addition, the EBL also makes certain requirements as to the disposal of bankruptcy property. For example, complete sets of equipment shall be sold as a whole, and that which cannot be sold as a whole may be sold in parts.⁹²

Finally, the EBL provides guidelines for the distribution of bankruptcy property. Any distribution plans shall be proposed by the liquidation team, and approved by the creditor's meeting, and submitted to the court for judgment before implementation.⁹³ Bankruptcy expenses, including litigation expenses, must be paid as a priority.⁹⁴ The remaining property shall be distributed in the order of: (1) wages of staff and workers and labour insurance expenses that are owed by the bankrupt enterprise; (2) taxes that are owed by the bankrupt enterprise; and (3) bankruptcy claims. Such an order with emphasise on workers' interests, which can be traced to the practice in the 1950s (described above), represents a difference from those in some other

⁸⁹ Art.28.

⁹⁰ Art.35.

⁹¹ Art.35.

⁹² Art.36.

⁹³ Art.37, par.1.

⁹⁴ Art.34.

jurisdictions. For example, in English insolvency law, taxes are placed before employees' remuneration.⁹⁵

By putting into the liquidation team a number of government officials and by imposing detailed guidelines for the treatment of bankruptcy property, the EBL shows that liquidation of bankrupt state enterprises must be carried out under the control of relevant government departments which will certainly take special care of state property in bankrupt enterprises. Although the EBL assumes that the liquidation team is responsible to, and shall report on its work to, the court,⁹⁶ it is far from clear how the court may actually supervise a liquidation team. There is, for example, no procedural provision whereby a liquidator may be removed. Moreover, as will be examined later, creditors of the bankrupt enterprise seem to be prevented from participating in the liquidation process, leaving their interests in uncertainty.

Fourthly, as far as liabilities are concerned, the EBL not only threatens relevant persons with criminal liabilities,⁹⁷ but also exposes them to possible administrative sanctions. Administrative sanctions may be imposed under two general circumstances. On the one hand, the legal representative⁹⁸ and the directly responsible personnel of the bankrupt enterprise shall be subject to administrative sanctions if the enterprise has committed any of the acts listed in Article 35 of the EBL (mentioned above). On the other hand, administrative sanctions may be imposed on the legal representative of the bankrupt enterprise, who are found

⁹⁵ See Schedule 6 of the Insolvency Act 1986.

⁹⁶ Art.24, par.3.

⁹⁷ Arts.41 and 42, par.4. It is clear that the crime provided in Art.42 (4) refers to dereliction of duty as provided in Art.187 of the Criminal law (1979). However, it is not clear what crimes may be imposed under art.41 of the Bankruptcy law. By referring to the activities stipulated in Art.35, Art.41 may cover Art.187, and Art.151 (theft) and possibly some other crimes.

⁹⁸ For a definition and explanation of this important concept, see Chapter Six of this thesis.

to be principally responsible for the bankruptcy of the enterprise. Moreover, where the superior governments in charge of the enterprise which is declared to be bankrupt shall bear the major responsibility for the bankruptcy of the enterprise, administrative sanctions shall be applied to the leaders of such superior departments in charge. In addition, the EBL seems to suggest that, as a principle, after an enterprise is declared bankrupt, the government "supervisory departments" (jiancha bumen) and audit departments shall be responsible for pinpointing the responsibility for the bankruptcy of the enterprise.⁹⁹

The EBL provisions on bankruptcy liabilities are principally aimed at forcing all relevant parties, especially enterprise directors and leaders of the superior departments in charge of enterprises, to do their best to prevent enterprises bankruptcy. This is largely in line with the aims of the economic reforms. What is, however, problematic is the application of administrative sanctions. First, provisions regarding administrative sanctions appear to be incompatible with the EBL as a whole.¹⁰⁰ It is because that administrative sanctions are not investigated and applied by the court. Nor would they be subject to any form of judicial review. Secondly, administrative sanctions seem to be imposed as a replacement for financial accountability, since no financial liability is applicable to relevant persons. Thirdly, the application of administrative liability represents a fundamental difference from the treatment under the Shenzhen Regulations. According to the Shenzhen Regulations, compensations, fines or criminal liabilities, where appropriate, may be applied to legal representatives, members of the board of directors or senior management personnel of

⁹⁹ Art.42, par.1.

¹⁰⁰ It is particularly inappropriate to add these provisions in Arts.41 & 41, as a part of Chapter Five: "bankruptcy declaration and bankruptcy liquidation".

the bankrupt companies.¹⁰¹ The reason for the exclusive application of administrative liabilities to managers in bankrupt state enterprises, and not to bankrupt foreign investment enterprises, is that state enterprises are legally owned by the state and government departments which are authorised to impose administrative sanctions. This fact also explains that, in state enterprises, directors' accountability to the government is still predominantly important.

The legal recognition of administrative sanctions is, to a large extent, a continuation of the previous practice whereby government departments used their administrative authority to manipulate enterprises. However, the legal provision of administrative liabilities for government departments in charge of bankrupt enterprises is unlikely to be strictly followed in practice. Indeed, in order to prevent their possibility administrative liability, the leader of the government departments will attempt to "save", with all possible means, subordinate enterprises from being subject to any bankruptcy proceedings. This may be the case especially where these leaders themselves are suspicious of being "responsible" for the bankruptcy of an enterprise under their supervision.

C. Protection of creditors' Interests

Article 1 of the EBL lists the protection of the "legal interests" of creditors as one of the main aims of the law. To a certain extent, the EBL attempts to offer protection to creditors of bankrupt enterprises. For example, creditors are entitled to file to declare the debtor bankrupt when the debtor is unable to repay debts that are due.¹⁰² Moreover, the EBL contains a special chapter on creditors' meeting (Chapter Three). The meeting shall have the following functions and powers: (1) to examine materials of proof

¹⁰¹ Arts.54 and 55.

¹⁰² Art.7.

relating to the claims, and to confirm the amount of such claims and whether or not the claims are secured with property; (2) to discuss and adopt a draft settlement agreement; and (3) to discuss and adopt a plan for the disposition and distribution of bankruptcy property.¹⁰³ In addition, creditors who owe debts to the bankrupt enterprise may offset them before the bankruptcy liquidation.¹⁰⁴

Some other protective provisions are, however, not clear. For example, property security system is still underdeveloped in China. The EBL does contain several provisions in relation to security. For example, secured creditors may enjoy the right to receive repayment with priority with respect to their security. With respect to claims that are secured with property whose amount exceeds the value of the security collateral, the part that is not repaid constitutes a bankruptcy claim, and will be repaid in accordance with the bankruptcy proceedings.¹⁰⁵ But the EBL seems to rule out the voting power of all secured creditors unless they abandon their priority right to be repaid.¹⁰⁶ Therefore, it seems that a secured creditor is prohibited to vote even in the respect of the balance (if this is the case) of his debt after deducting the value of his security.¹⁰⁷

Furthermore, since any resolution adopted by unsecured creditors shall have binding force on all creditors, it is unknown whether a secured creditor who does not have the voting right is allowed to ask the court to review such a resolution.¹⁰⁸ In addition, although the creditors' meeting

¹⁰³ Art.15.

¹⁰⁴ Art.33.

¹⁰⁵ Art.32.

¹⁰⁶ See Art.13. Also see Art.16.

¹⁰⁷ Such protection is, however, provided in the UK Insolvency Rules 1986 (Section 2.24).

¹⁰⁸ Art.16, par.3 only generally authorises "creditors" with such rights.

may discuss and adopt draft settlement agreements,¹⁰⁹ and it may in certain circumstances ask the court to terminate the reorganisation procedure,¹¹⁰ it is questionable how creditors may supervise the reorganisation. For example, while the term for any reorganisation should not exceed two years,¹¹¹ the EBL merely requires that the reorganisation process shall be reported to the creditors' meeting "periodically" (dingqi), and fails to make any specific provisions as to such reporting activities.

Thus, the protection of creditors' interests is problematic. In fact, there are mainly two policy factors which directly affect the balance of interests between debtor enterprises and creditors. First, as explained earlier, the strict and not completely clear provisions concerning both the tests for bankruptcy and the exclusion of bankruptcy proceedings, as provided in Article 3 of the EBL, operate to restrain creditors from initiating bankruptcy applications. Secondly, the active role played by government departments, especially those in charge of enterprises, as recognised throughout the EBL, necessarily puts creditors' interests in danger. Indeed, a comparison between the PRC EBL and the Bankruptcy Law currently operating in Taiwan suggests that, while the later pays great attention to the interests of creditors, the former tends to protect the debtor enterprises.¹¹² For example, while creditors in Taiwan can appoint supervisors to check the activities of a liquidation committee, the EBL does not provides creditors with any rights and remedies in relation to a liquidation team.

It must be pointed out, however, that, not every creditor

¹⁰⁹ Art.18, par.1.

¹¹⁰ Art.21.

¹¹¹ Art.17.

¹¹² See Li Chunmin and Wei Xing, "Haixia Liangan Pochanfa Zhuyao Neirong Zhi Bijiao Yanjiu" (Comparative Studies on Main Contents of Bankruptcy Law Across the Taiwan Straits), FXYJ, No.5, 1990, pp.53-7.

enterprise in the PRC seems to care very much about its interests. As for state enterprises, since many of their creditors are state institutions and fellow state enterprises, the protection of creditors' interests appears to be less important as the property of bankrupt enterprises may just flows from one to another pocket of the state.

IV. The EBL and Consolidation of Companies

The EBL came into force on November 1, 1988. As mentioned earlier, it had been predicted by Chinese officials that bankruptcy cases following the adoption of the EBL would be "few". Nevertheless, it seems that until 1991, the number of bankruptcy cases may well have been fewer than had been anticipated.¹¹³ In practice, the EBL is frequently put aside by the government.

Between late 1988 and late 1991, the Chinese government conducted the "rectification and consolidation" (zhili zhengdun) of the economy. One of the main themes of this campaign was to "reorganise companies" (zhengdun gongsi).¹¹⁴ On October 3, 1988, the Central Committee of the CCP and the State Council jointly issued the "Decision Regarding Clearing and Reorganising Companies" ("Decision").¹¹⁵ The background for launching this campaign was rather complicated. Many companies were established and operated by government departments and officials concurrently holding government and Party positions. Some companies possessed both the right to carry out business and the power to exercise administrative control. Because of the involvement of government departments

¹¹³ Until early 1991, just more than 170 state enterprises had been declared bankruptcy in accordance with the Bankruptcy Law. Information from ZZJJTZGG, No.5, 1991, p.34.

¹¹⁴ For a description of the concept of "company" and its connections as well as differences with that of "enterprise", see Chapter One of this thesis.

¹¹⁵ For the text in Chinese, see Bulletin of the State Council, No.23, 1988, pp.739-41.

and officials, many companies were able to engage in "official profiteering" (guandao) which disrupted the economic order and shook people's confidence in the government.

The main targets of this campaign were companies that were established after late 1986, especially those having multiple operations and functions, those engaging in financial, and circulation activities. Companies that were formed before late 1986 and that had "serious problems" should also be cleared and reorganised.¹¹⁶

Like the previous consolidations of enterprises in the early 1960s and early 1980s, this reorganisation relied exclusively on administrative measures. The Decision required that reorganisation to be carried out by government departments at all levels.¹¹⁷

Many measures were introduced and implemented in this campaign. For example, the administrative functions of companies were ordered to be cancelled. Moreover, government and Party officials, including retired officials, were instructed to distance themselves from any such companies.¹¹⁸ Most importantly, all companies that did not possess necessary conditions and that "lack the necessity to exist" should be resolutely abolished or amalgamated, with their property and

¹¹⁶ Ibid, par.1. The main reason why a line was drawn for 1986 was that, there was formerly a consolidation on companies which started in 1985 and concluded in 1986. For a brief description of this campaign, see Chapter Three of this thesis.

¹¹⁷ Ibid, par.9.

¹¹⁸ See "Zhonggong Zhongyany Bangongting, Guowuyuan Bangongting Guanyu Xianyishang Dang He Guojia Jiguan Tuilixiu Ganbu Jingshang Banqiye Wenti de Ruogan Guiding" (Some Provisions Concerning Retired Cadres of the Party and the Government Offices Who Are Engaged in Doing Businesses and Operating Enterprises, Issued by the Office Departments of the CCP Central Committee and the State Council on Oct.3, 1988). For the text in Chinese, see Bulletin of the State Council, No.23, 1988, pp.741-42. Also see, "Guanyu Guojia Jiguan Ganbu Zai Gongsi (Qiye) Jianze Youguan Wenti de Tongzhi" (Circular Concerning Government Officers Concurrently Holding Positions in Businesses (Enterprises), Feb.5, 1989). For the text in Chinese, see ibid, No.1, 1989, pp.41-2.

funds seized for the repayment of their debts.¹¹⁹

During this campaign, companies to be abolished or amalgamated were required to go through the procedure of clearing up its debts as well as its claims. In early 1990, the Ministry of Finance, the People's Bank of China and the National State Assets Administration Bureau jointly issued a Circular on Clearing Up Property, Claims and Debts of Abolished or Amalgamated State-Owned Companies ("Circular").¹²⁰ In December 1990, the State Council promulgated Provisions on Clearing Claims and Debts of Abolished or Amalgamated Companies ("Provisions").¹²¹ Both the Circular and the Provisions provided detailed guidance in dealing with issues of liability and property disposition. The liability issue, including especially the limited liability of companies as legal persons and the liability of government departments as promoters, is discussed elsewhere in this thesis.¹²² As far as the debts issue is concerned, the repeated call for clearing up debts to some extent reflected a departure from the past PRC practice whereby the state might transfer, cancel, or reduce debts and claims of any kind. In this sense, the EBL which aims to sort out debts and liability of enterprises has had some positive impact on the reorganisation of companies.

Although some companies were found to be insolvent because their assets were insufficient to repay their debts, it is interesting to note that the EBL itself was not mentioned by either the Circular or the Provisions. Since this reorganisation was purely an administrative campaign, the clearing up of debts and claims was put under the exclusive

¹¹⁹ Ibid.

¹²⁰ For the main text in Chinese, see FZRB, Feb.16, 1990, p.2.

¹²¹ For the main text in Chinese, see RMRB, Dec.23, 1990, p.2. These Provisions applied to companies operated by mass organisation and social groups as well, therefore having broader application than the Circular.

¹²² See Chapter Three of this thesis.

control of government departments in charge of companies, as well as special liquidation teams. These teams were organised by superior departments in charge of companies and were consisted of members of all relevant government departments and other relevant persons.¹²³

In addition, there are two main differences between bankruptcy proceedings and the administrative handling of debts. First, while the EBL provides for three orders in terms of priority for repayment from bankruptcy property, both the Circular and the Provisions created four orders. It was expressly provided that repayment from property of abolished companies, should be made in the order of: (1) reasonable wages and living expenses (of workers and staff); (2) taxes that are owed by the abolished company in accordance with the law; (3) loans granted from state banks, credit cooperatives and other financial institutions; and (4) other claims. And where the property was insufficient to repay all the repayment needs in a single order, it should be distributed on a pro-rata basis. The main feature in this arrangement, which differed from the EBL, was that financial loans were put as a priority over other claims. Those which provided loans were treated as de facto secured creditors. This reflected the state's concern over the scale of company's loans from banks, especially from state banks. Secondly, the EBL provides that creditors who do not report their claims within a certain period, shall be deemed to have automatically abandoned their claims.¹²⁴ In contrast, the Provisions explicitly required that all claims must be "sought to be repaid positively" (zhudong zhuichang) by superior government departments in charge and the liquidation teams.

Nevertheless, as far as the distribution of property is concerned, the EBL and the government reorganisation of companies share one common feature. That is, to a large

¹²³ See Circular, par.1, supra note 118.

¹²⁴ Art.9. The period is one month for those who have been notified, and three months for those not.

extent, the distribution is a one-way action administered by government authorities (including government-controlled liquidation teams). As a matter of fact, many creditors remain too passive to defend their legal rights and recover their claims. What they can do is to wait, rather than to fight, for their share of property in an insolvent enterprise.

It seems that administrative manipulation of assets distribution of an insolvent enterprise might be more effective than the formal and legal bankruptcy proceedings. This is mainly because that it serves to fit more with the government's intentions and it is exclusively controlled by the government. Moreover, state property, especially that in the form of state loans, can be more favourably protected in administrative reorganisation than in ordinary bankruptcy proceedings. But whatever ideal effects this administrative reorganisation may produce, it is a fact that the newly introduced EBL is almost drowned in the administrative campaign.

Since the late 1980s, the Chinese government has attempted to avert bankruptcy proceedings by encouraging the "takeover" (jianbing) between enterprises. One way to carry out this is to let a creditor enterprise takeover its debtor enterprise that is insolvent. In the campaign to consolidate companies, some companies were ordered to be amalgamated with other enterprises. The above mentioned Circular provided some guidelines for this kind of amalgamation. For example, while the property of a state company had to be transferred for value to a non-state company, the transfer of property from a state company to a fellow state company might be made either for value or in accordance with administrative arrangements, depending on the decisions made through negotiations among relevant government departments. Moreover, all the funds as well as claims and debts that had not been cleared up by a company to be taken over should be transferred to another company that absorbed the company. One advantage for this kind of merger is that workers and staff, if they wish, can be transferred to the absorbing company, reducing the pressure of

unemployment.¹²⁵ It is likely that government departments may order an efficient enterprise to take over an inefficient enterprise. As a result, the possibility for bankruptcy proceedings is further cut down.

V. Conclusion

The introduction of the bankruptcy policy in post-Mao China was once seen by many reformers as a necessary tool for state enterprise reforms because the threat of bankruptcy would force enterprises to make better performance and enhance economic efficiency. Thus, in spite of notable opposition, the EBL was adopted in 1986.

The adopted EBL, however, is far from radical. The EBL not only preempts the occurrence of bankruptcy proceedings in many circumstances, but also inherits many features of the past PRC practices regarding enterprise reorganisation. Most notably, government authorities are placed by the EBL at a dominant position in the liquidation and reorganisation of bankrupt enterprises. To a great extent, this has been carried out at the cost of creditors' interests.

The EBL today remains a "paper tiger" as only a few bankruptcy cases have been adjudicated by the court. Indeed, until early 1992, the Chinese leadership has been reluctant to enforce the EBL. Three factors may explain the reasons for the failure of the bankruptcy policy. First, many creditors remain passive. They are either not very interested in, or prevented by the government from, initiating bankruptcy proceedings against debtor enterprises.¹²⁶ Secondly, debtor enterprises

¹²⁵ For an analysis of the legal characteristics of enterprise mergers, see for example Fu Tingmei, "Qiye Jianbing de Falü Tezheng Chutan" (Preliminary Discussion on the Legal Features of Enterprise Mergers), FZRB, Sept.7, 1988, p.3.

¹²⁶ It has become common practice in contemporary PRC that debtors are in a superior position to their creditors. Often creditors have to beg debtors in order to obtain a settlement. Few creditors would regard bankruptcy filings as the best way to realise their rights.

themselves are prevented by government departments from filing bankruptcy applications. Thirdly, government departments tend to "save" their subordinate enterprises from bankruptcy proceedings. This can be carried by, for example, providing help to an insolvent enterprise. Moreover, neither the SEL nor the EBL provide clear guidance for the administrative reorganisation of enterprises.¹²⁷ Thus, the government may make unilateral decisions to reorganise enterprises. Such administrative actions may pre-empt many genuine bankruptcy cases. Enterprise insolvency found in the course of administrative reorganisation are handled by administrative authorities without resorting to, and even contradicting, the EBL provisions.

A proper implementation of the bankruptcy policy would require many legal as well as non-legal conditions. The EBL was adopted without resolving a number of social, economic and political difficulties. The irrational pricing policy continues despite the government's promise, and indeed some undergoing actions, to reform in this respect. The unemployment threat has been picked up by many as an excuse for delaying the implementation of the EBL. The pursuit of economic efficiency at the cost of "social efficiency" remains officially unacceptable. Furthermore, enterprises are still under extensive government control and do not have a significant degree of autonomy in decision-making.

Bankruptcy is a phenomenon necessarily associated with market economies. The absence of a genuine market economy in the PRC means that there is little impetus for the implementation of the bankruptcy policy. Nevertheless, in the light of the recent official calls for the development of a market economy, it is possible that the bankruptcy policy will be implemented more radically in China. And in that case, an overhaul of the existing EBL is needed, in order not only to limit the dominant role of government authorities, but also to provide favourable protection to the interests of creditors.

¹²⁷ Such a guidance is, however, stipulated in the Shenzhen Regulations (supra note 54).

CHAPTER NINE

THE CONTRACTING (CHENGBAO) SYSTEM: LAW AND PRACTICE

This chapter discusses the contracting, or chengbao, system implemented in state enterprises. Although several aspects of this system have been discussed in previous chapters,¹ this discussion is very necessary in that it will examine the chengbao system broadly as an important legal mechanism employed by the Chinese reformers for settling the relations between the state and state enterprises.

This chapter commences with a general description of the role of legal contracts in the post-Mao economic reforms. The nature of the enterprise chengbao system is then analyzed. The discussion continues to explore the practical and theoretical confusions existing within the chengbao system. In order to explain many policy considerations underlying the chengbao system and its practical predicament, a brief comparison is made between the chengbao system and the leasing system (zulin zhi). Finally, a conclusion is offered with an analysis of the functions and the limits of the chengbao system in state enterprise reforms.

I. Contracts and Post-Mao Economic Reforms

Since 1981 when the economic responsibility system was first suggested to be implemented in state industrial and

¹ For example, the impact of the chengbao system on the financial autonomy of state enterprises was discussed in Chapter Five.

transportation enterprises,² many forms of the responsibility system have been tested in China. In 1988, the SEL singled out chengbao (contracting) and zulin (leasing) as two principal forms to be implemented nationwide.³ In addition, however, the shareholding system, or gufenzhi, has been cautiously experimented with since the mid-1980s.⁴

Of these reforms, the chengbao system has been the most important approach. Since 1987, over ninety per cent of all large and medium-sized state enterprises have implemented this system. In contrast, the zulin system is applied only to small enterprises and therefore has had a limited impact on state enterprise reforms.⁵

The chengbao system currently applied to state enterprises is by no means the first experiment of its kind in post-Mao economic reforms. The much celebrated rural economic reforms implemented since the late 1970s provided a good example of the immense effectiveness of the chengbao system. In 1982, this system was introduced in Chinese rural areas. From then on, contracts based on some formal regulations⁶ have replaced compulsory orders as a dominant mechanism for structuring the relationship between peasant producers on the one hand and the state and the collectives on the other. Based

² In April 1981, the State Council convened a national conference on industrial and transportation work. See Guowuyuan Pizhuan Guojia Jingji Weiyuanhui He Guowuyuan Tizhi Gaige Bangongshi Guanyu Shixing Gongye Shenchan Jingji Zerenzhi Ruogan Wenti de Yijian (The State Council Approves and Transmits the Opinions on some Issues Concerning the Implementation of Economic Responsibility System in Industrial Production, Oct.29, 1981).

³ Art.2.

⁴ For an assessment of this system, see Chapter Ten below.

⁵ For a detailed comparison between chengbao and zulin, see the later discussion in this chapter.

⁶ For example, "Agricultural Sideline Production Contract Regulations", issued by the State Council on Jan.23, 1984, translated into English in JPRS China Report (Agri.), Sept.10 1984, pp.61-9.

on case studies, some observers praised the chengbao system by concluding that

[t]he new rural contracts have far-reaching implications for China's future. This is particularly true as the contracts establish the rule of law, revamp rural politics, and link complex economic relations in a mixed plan-and-market economy.⁷

The great success of the chengbao system in rural implementation encouraged the Chinese leadership to extend this practice to the industrial sector. As explained in Chapter Four, the gradual expansion of enterprise autonomy has been the main thread for enterprise reforms. However, as state enterprises had to bargain with the state and government authorities for more powers, and as many government departments which used to dominate enterprise management were reluctant to hand over their powers, there was great flexibility in the relations between the government and enterprises. Such flexibility proved to be unfair for different enterprises and constituted one of the major obstacles to the expansion of enterprise autonomy.

In fact, in the industrial sector, chengbao had been practised between 1981 and 1983. As examined in Chapter Five, that chengbao was aimed at giving enterprises an opportunity

⁷ David Zweig and others, "Law, Contract, and Economic Modernisation: Lessons from the Recent Chinese Rural Reforms", in Stanford Journal of International Law, Vol.23, 1987, pp.319-64, at 361. And see also Crook, "The Baogan Daohu Incentive System: Translation and Analysis of a Modal Contract", in China Quarterly, No.102, 1985, pp.291-303. Unfortunately, this contract system has been largely abolished as the State Council decided in late 1990 to reintroduce the previously practised state procurement policy whereby peasants are forced to fulfil the tasks ordered unilaterally by the government in regard to the submission of grain. The reasons for this policy shift were manifold. Apart from that peasants were alleged as frequently ignoring legal contracts, one official explanation did refer to the fact that the submission of grain according to contracts was not different from state procurement. Therefore in the opinion of the government, for the purpose of describing the nature of the state policy, the use of procurement is actually more precise than contracts which was misleading. For a report of the government decision as well as the official explanation, see RMRB (Overseas edn.), Oct.12, 1990, p.1.

to share profits. If an enterprise could effectively make more profits than a base amount settled in advance by negotiations between government authorities and the enterprise concerned, it would be entitled to share certain percentage of the profits in excess of the base amount. However, that chengbao system failed to achieve success and was later replaced by a new tax-for-profit system. One of the reasons for the failure of that period of chengbao was that the old system of administrative control by the government remained unchanged. Government departments still occupied a superior position to control a number of matters ranging from the settlement of base amount of profits to direct enterprise management. In addition, the failure to fulfil the fixed base amount included in chengbao did not result in any liability for either enterprises, their managers or government authorities.

The unsatisfactory chengbao practice in the early 1980s, however, did not make the Chinese leadership lose its confidence in the chengbao system itself. Since it was reintroduced nationally in 1987, the chengbao system has been vested with a number of new contents and new characteristics. Most notably, the legal and contractual mechanism has been introduced in an attempt to achieve a fair balance of interests among the state, enterprises, and their managers.

II. Legal Nature of Enterprise Chengbao Contracts

The chengbao system applied since 1987 has been repeatedly praised by the Chinese authorities as well as by many academics. At the very beginning when this system was extensively applied, many hopes were put on it. One academic writer predicted in 1987 that, for Chinese state enterprises, the chengbao system would lead to a fundamental change in the relationship between the state and state enterprises, and the essential significance was, "from status appendage to the

formation of contractual relations",⁸ -- much like the function which the institution of the contract had played in the European civilisation. In his view, the relationship between the government and enterprises would experience radical changes from the old system in which enterprises were primarily subordinate to government manipulation to a new system in which legal and contractual, rather than purely administrative, relations were the norm. Nevertheless, one has to look at both the provisions in relevant regulations and the chengbao practice in order to find out whether this prediction accorded with the reality or was just a sincere hope.

On February 27, 1988, the State Council issued the Provisional Regulations Concerning the Contracting Management Responsibility System in State Industrial Enterprises ("Chengbao Regulations").⁹ The basic principles governing government-enterprise relations, as embodied in the Chengbao Regulations, are that an enterprise guarantees a "base figure" (jishu), ensures payments to the state, retains extra profits, and makes up for any losses from its own reserve fund.¹⁰ The main objectives for implementing the chengbao system are stated as: enterprises must guarantee profit payments to the state, ensure completion of technology transformation, and link up their gross payroll with their economic productivity.¹¹

A chengbao contract must contain the following provisions:

⁸ See Gu Peidong, "Chengbao Jingying Zerenzhi de Faxue Tanta" (Discussions on the Legal Aspects of the Chengbao Management Responsibility System), in GMRB, Sept.12, 1987, p.3. Reproduced in JJF, No.5, 1987, pp.89-90.

⁹ For the text in Chinese, see Law and Regulations of the PRC (1988), pp.735-44.

¹⁰ Art.5, ibid.

¹¹ Art.8, ibid.

- (1) the form of the chengbao contract,¹²
- (2) the duration for this chengbao contract;
- (3) the amount of profit to be turned over or that of the losses to be reduced;
- (4) compulsory state supply plans and production plans;
- (5) production quality and other main economic and technological targets;
- (6) technology transformation tasks, preservation and appreciation of state property;
- (7) use of retained profit, return of loan, arrangement for the credit and/or debt existing before this chengbao;
- (8) respective rights and duties of both parties;
- (9) responsibilities for breach of contract;
- (10) award and punishment for an enterprise manager;
- (11) other items agreed by both parties.¹³

Despite such detailed provisions, it is disputable whether chengbao contracts are in essence economic contracts. The Economic Contract Law ("ECL") was promulgated in 1981, and it did not provide for the regulation of chengbao contracts. In fact, the implementation of the rural contracting system had to rely mainly on separate legislation such as the Agricultural and Sideline Production Contract Regulations.¹⁴

Some Chinese scholars have been optimistic in that they insist a chengbao contract is basically a civil or economic contract.¹⁵ They argue that both parties to the contract "are

¹² According to Art.9 of the Chengbao Regulations, there are usually four forms: (a) turning over to the state a guaranteed amount proportional to profit; (b) turning over to the state a guaranteed base figure amount of profit, the remainder to be divided; (c) turning over to the state by enterprises making small profits a fixed amount of profit; (d) reducing losses (or compensating) for enterprises experiencing losses. For a discussion of the application of these forms, see Chapter Four of the thesis.

¹³ Art.16, Chengbao Regulations.

¹⁴ See supra note 6.

¹⁵ See for example Professor Sun Yaming, "Shixing Chengbao Jingyingzhi Zhide Tantao de Falü Wenti" (Some Legal Issues Concerning the Implementation of Chengbao Management System), in FXZZ, No.2, 1988, pp.8-9. Reproduced in JJF, No.6, 1988, pp.46-7. In China, despite the differences existing between a civil contract and an economic contract, the principles of civil law regarding civil contracts shall apply to economic contracts which may be generally regarded as a type of civil contract.

in an equal position not only in their rights and duties but also in their performance of the contract".¹⁶ Moreover, a recognition of the civil nature of such a chengbao contract would, in their view, ensure that enterprises finally escape from government administrative intervention.

Many other observers are, however, not so optimistic. They view the chengbao contract as "a type of special contract possessing both administrative and civil legal relationship".¹⁷ In other words, a chengbao contract is neither purely economic nor purely administrative, but a hybrid contract in nature. Thus, the legal regulation of chengbao contracts must consider both the aspects of administrative control and the general principles of economic contract law.

The debate on the legal nature of chengbao contracts has both theoretical and practical implications. In order to reveal the true nature of chengbao contracts, a comparison between chengbao contracts and ordinary economic contracts must be made in three aspects: principles for the formation of a contract, the status of contractual parties, and the objects of a contract.

A. Principles for the formation of a contract

Chengbao contracts are not formed in accordance with the same principles as those which must be applied to the formation of ordinary economic contracts. Article 15 of the Chengbao Regulations provides that "in concluding a chengbao contract, both parties must comply with the principles of equality, voluntariness and negotiation". The ECL states, however, that the formation of economic contracts must be

¹⁶ Sun, ibid. p.47.

¹⁷ See Cheng Yongji, "Chengbao Jingying Zerenzhi de Zhuyao Jingji Guanxi Jiqi Falu Tiaozheng" (Main Economic Relations in, and the Legal Regulations on, the Chengbao Management Responsibility System), in JJFZ, No.1, 1988, pp.10-13. Reproduced in JJF, No.1, 1988, pp.69-72.

based on the principles of equality and mutual benefit; negotiation and coincidence of opinions; and making compensation for equal value.¹⁸ Similarly, Article 4 of the GPCL states: "in civil activities, the principles of voluntariness, fairness, making compensation for equal value, honesty and credibility shall be observed." Among these three different sets of principles,¹⁹ those provided in the Chengbao Regulations are obviously the narrowest. The most significant omission in the Chengbao Regulations is the principle of mutual benefit, or more radically, "making compensation for equal value" (dengjia youchang). Although the principles of equality, voluntariness and negotiation may provide both parties with an opportunities for achieving mutual benefit, this may not always be the case.

Of the main contents covered in a chengbao contract, some are directly involved with economic interests, but others are not. It would be incorrect to hold that the involvement of non-economic interests would necessarily prevent a contract from becoming an economic contract. This is because, as recognised in the ECL,²⁰ not only goods but also services can be valued in the contract. Nevertheless, it is reasonable to view the listing as contractual targets of non-economic interests as an obstacle in realising the principle of dengjia youchang. Let us take the issue of technological transformation as an example. In practice, some chengbao contracts have "capitalised" this item by, for example, providing in a contract the amount of money with which the contractor must invest in technological development.²¹ On the

¹⁸ Art.5.

¹⁹ One should also note some fundamental principles in some other connected articles, for example, the equality principle in Art.2 of the GPCL.

²⁰ For example, Art.19, on processing and contracting contract.

²¹ See the Research Group on the Chinese Enterprise System Reform, Chengbaozhi Zai Shijian Zhong (The Chengbao System in Practice), Economic Management Press (Beijing) 1988, case 2.7,

other hand, some chengbao contracts have adopted non-economic and flexible methods taking into account technological development such as a rise in product quality,²² but without specifying the amount of money with which the contractors must invest in technological development. In addition to technological development, some chengbao contracts contain such criteria as the degree of "civilisation" (wenming), safety of production and prevention of serious pollution.²³

Thus, while the maximisation of financial profits is undeniably an important aim for the state as the owner of enterprises, the state has to look at both the long term and the short term, and to take into consideration not only financial interests but also many social factors. Enterprises themselves, especially the directors, are more interested in making maximum profits in short term, that is, within the terms of the immediate chengbao, regardless of any economic or social costs. This is particularly obvious as some managers are likely to quit their jobs when the term of chengbao expires.²⁴ Thus, to a large extent, it is mainly the state, as the party that offers the contract, which seeks to impose

pp.25-7. The contract in this case provided that during the term of chengbao time, the contractor--Nanjing Oil Chemical Plant had to invest in technological transformation 6.9 million RMB Yuan, including 5.3 million of state loan and 1.6 million of self-raised money. The contract also continued to provide for the use of this amount and the way to repay the state loan.

²² See ibid. case 2.5, pp.22-3. The quality in this case was to be valued by the level of excellence (provisional, ministerial, or national) certain products have finally reached. The exploitation and subsequent putting into operation of new products were also listed in the contract as a criterion for assessing technological transformation.

²³ Supra note 21, case 2.7.

²⁴ Art.31 of the Chengbao Regulations provides that "when the term for the chengbao expires, the enterprise leading body responsible for chengbao shall be dissolved." Here "leading body" refers to the director, deputy directors and other relevant management personnel who are selected by, and supposed to assist, the director to charge the implementation of the chengbao contract.

many non-economic goals on enterprises. These non-economic targets, when added to economic targets, have contributed to a very complex system in which a variety of terms are included in a chengbao contract. Such a system makes the notions of "mutual benefits" and "equal values" in a chengbao contract both undesirable and impractical.

B. Status of contractual parties

As shown above, the fact that the ambiguity of the dengjia youchang principle makes chengbao contracts different from typical economic contracts. Nevertheless, in justifying their assertion that chengbao contracts are in essence economic contracts, many Chinese lawyers have attempted to avoid discussing the principle of "making compensation for equal value". Instead, they are more interested in exploring the wording of "equality" between the state and enterprises, in the hope that equality, voluntariness and negotiation can help both parties to achieve fairness in chengbao contracts. Therefore the status of contractual parties must be examined.

Generally speaking, the parties to a chengbao contract are the state (usually called "the party that offers the contract" or fabaofang) and an enterprise ("the contractor" or chengbaofang). The state, being an abstract norm, is represented by government departments. Within each level of the government, there are many specialised ministries or commissions (at central level), bureaux, departments and offices (at provincial, prefectural, municipal and county levels).

In some cases, a chengbao contract is concluded between an enterprise and several government departments. but in other cases, a chengbao contract may be signed between an enterprise and a single government authority. This is especially the case when this single authority has itself contracted with its superior government ("contracting for an industry", or hangye chengbao).

In addition, in some cases, the party that offers the

contract appears to be the highest authority within the enterprise concerned, rather than superior government departments in charge of the enterprise. In one such case,²⁵ such highest authority was a board of directors. However, the establishment of the board does not make any difference. There are two major reasons. First, such cases are exceptions rather than general practice. Secondly, government officials are always present in the boards. In the above mentioned case, the board was headed by a local government officer and composed of government officials as well as the leaders of the enterprise, including the manager, the Party secretary and the president of the trade union.

The direct official involvement, either through its departments or through its officers, must be seen from two different but almost inseparable perspectives. One is the government as the owner of state enterprises. It is theoretically possible, from this point of view, for the owner and the enterprise to reach, on the basis of equality, a civil or economic agreement. But the issue is not so simple as the government has another function, namely as the administrator of the economy. The most important tools for the government are economic planning and administrative supervision. For example, the government has considerable power to decide financing, pricing, taxation and many other issues.²⁶ Government control based on the factors of both ownership and administration has cast shadow on the principle of equality.

The vertical administrative relationship between the government and enterprises poses a threat to the principle of equality. In order to achieve equality, it is necessary to cut off the vertical administrative relations and replace them with pure horizontal relations whereby the government and state enterprises have equal basis for the bargaining in, and for the enforcement of, chengbao contracts. The idea that the government should separate its administrative function from

²⁵ Supra note 21, case 1.5, p.6.

²⁶ For a discussion, see Chapter Four of the thesis.

ownership function has paved the way for the chengbao system. But the problem remains whether a chengbao contract can contain any "equality" at all.

It must be admitted that the term of "equality" has been understood in different ways among Chinese scholars. Some observers²⁷ have analyzed the meaning of equality in terms of three aspects: status, effectiveness of expression of intentions, and rights of parties involved. But as mentioned above,²⁸ some emphasize the equality in rights and duties of both parties and in the fulfilment of contracts. In addition, there are some²⁹ who insist that an enterprise and the party that offers the contract are subordinate and superior authorities in an administrative relationship; equal contractual parties in a contractual relationship; and possible plaintiff and defendant in a litigious relationship. Therefore the concept of equality does not seem to have the same generally agreed contents.

The notion of equality, as reflected in the Chengbao Regulations, has two main aspects. The first is in the sense of rights and duties respectively provided in Articles 22 and 23. The party that offers the contract is entitled, in accordance with the provisions of a chengbao contract, to inspect and supervise the contractor's production and management activities. It shall also, in accordance with the provisions of a chengbao contract, protect the legal rights of an enterprise and its manager, and help to coordinate and resolve the enterprise's difficulties in the process of production and management. Accordingly, an enterprise as the contractor enjoys management autonomy provided in laws, regulations, policies and in a chengbao contract. And it must

²⁷ See Li Xiangru and Tang Fang, Hetong (Contracts), Law Publishing House (Beijing) 1987, p.2.

²⁸ Sun, supra note 15.

²⁹ See Sheng Guansheng, Ruhe Chuli Chengxiang Chengbao Hetong Jiufen (How to Handle Disputes Concerning Chengbao Contracts in Cities and Countryside), Enlightenment Daily Press (Beijing) 1987, especially at 67.

also carry out all the obligations provided in a chengbao contract.

The second area showing the "equality" between two parties are the consequences for one, or both parties which fail to carry out contractual duties. Article 24 of the Chengbao Regulations provides that the party that offers the contract must bear the responsibility for breach of contract, and its responsible persons may be subject to administrative and economic sanctions. Article 25 also makes similar provisions for enterprises and their managers. Furthermore, according to Article 20, in the process of performing a contract, the party that offers the contract is entitled to rescind the contract if it finds that the contract is not being properly implemented due to the poor management of the contractor. Equally, a contractor is entitled to propose to do so if it finds that the party that offers the contract has breached the contract in such a way that the enterprise cannot fulfil the contract. In addition, Article 19 provides that, if the State Council has made important changes in taxation (including the types and rates of taxes) or in the pricing of mandatory planning products, both parties may negotiate for the alteration of a chengbao contract. And in case of the appearance of force majeure or some outside and unavoidable reasons unconnected with the fault of any party, both parties can negotiate for the change or rescission of a chengbao contract.

These provisions regarding the equality of parties are to some extent similar to those stipulated in the ECL. It seems that, for the party that offers the contract, there would be no administrative intervention, except for its contractual rights provided in detail in a chengbao contract. But does this mean that the very form of a chengbao contract has effectively excluded the possibility of government administrative intervention?

The right of inspection and supervision by the party that offers the contract may offer a good example for the present analysis. The ECL contains similar provisions regarding, for

example, the contract of processing and contracting. Article 19 of the ECL states that a contractor in such a contract "must accept necessary inspection and supervision from the party that orders the object of the contract". But it is inappropriate to confuse this kind of inspection and supervision with that in a chengbao contract. The Chengbao Regulations do not expressly provide for the contents of such supervision and the manner in which such supervision is to be exercised, except by generally providing that it should be "in accordance with the contract". It is suggested³⁰ that this kind of inspection and supervision may refer to the areas of production plans, the realisation of profits, the preservation and renewal of enterprise property, the technological transformation, the use of retained profits, the compliance by the enterprise with the financial disciplines and even the actual implementation by the enterprise of economic contracts with third parties. Thus the right of inspection and supervision in a chengbao contract may be so broad that it is simply beyond the capacity of any contract to have all these recorded in advance.

The right to inspect and supervise enterprise's management and production was formally an important part of the administrative functions executed by government authorities in their capacities as both social and economic administrator and enterprise owner. Even after the conclusion of a chengbao contract, the party that offers the contract has retained the same dual capacity. An effective mechanism by which the owner and the representatives of state property are separated from the administrator of the economy has so far failed to be properly established. Therefore, it would be unrealistic to classify the right of inspection and supervision in a chengbao contract as a purely civil contractual right.

³⁰ See Sheng Guansheng, ibid., p.124. Also see Wang Shirong and others, Chengbao Jingying Zerenzhi de Falü Wenti (Legal Issues Concerning Chengbao Management Responsibility System), Machinery Industry Press (Beijing) 1988, p.74.

In fact, the right of inspection and supervision, as recorded in the Chengbao Regulations, must be seen as the combination of both administrative and civil contractual rights. The party that offers the contract is particularly keen to inspect and to supervise the contractor when the former is itself a contractor with a superior government authority. Since a chengbao contract may contain certain state plans, failure to effectively inspect and supervise the contractor may incur severe administrative penalties on the party that offers the contract. The provisions concerning the possible rescission of a contract in case of any breach may be seen, from the standpoint of the party that offers the contract, as not only a right, but also an administrative and contractual duty. Furthermore, failure to fulfil a chengbao contract may cause not only economic but also administrative liabilities on the party that offers the contract and relevant responsible persons.³¹

Thus, the mere conclusion of a chengbao contract cannot eliminate the possibility of administrative intervention. To a great extent, chengbao contracts have converted former administrative powers of government departments into their "contractual" rights. By making this conversion, government departments, as the party that offers the contract, has added in the contracts some provisions which may be nominally the same as, but in fact fundamentally different from, those which exist in typical economic contracts.

In returning to the issue of equality between chengbao parties, one has to admit that this equality principle has been undermined by the failure in the contract to prevent "administrative functioning" by the party that offers the contract. The equality of parties is superficial rather substantive. The party that offers the contract can still "lawfully" intervene in enterprise management by holding those rights which are not only civil but administrative in essence.

³¹ See Art.25 of the Chengbao Regulations.

C. Objects of a contract

The objects of chengbao contracts are far from clear. Chinese scholars are used to analyzing legal relations in three-fold terms, namely, subjects, contents and objects. "Subjects" refers to the parties involved. "Contents" concerns the rights and duties provided in a contract. And "objects" (keti) are the targets to which the rights and duties are directed. As far as a chengbao contract is concerned, as shown above, the subjects and contents are relatively easy to identify. However, as for the nature of contractual objects, there have been at least four different views on this problem.³² They are: (a) enterprise's management rights; or (b) chengbao targets and aims or the act of management; or (c) the combination of the above (a) and (b); and (d) the total assets of the contracted enterprise. This disagreement shows a failure which the law should have made clear. Indeed, the existence of such controversy reflects once more the confusion over the nature of a chengbao contract.

It is obvious that a chengbao contract must define the rights and duties of both the contractor and the party that offers the contract. At first sight, the four different opinions on the objects of a chengbao contract as cited above are all relevant. Without the property (that is, the total assets of the contracted enterprise), the contractor would not be able to perform the contract. Since the ownership rights of this property belong to the state, the contractor would not be able to operate if the state would not confer management rights on it. Furthermore, it is clear that the primary purpose for defining rights and duties of both parties involved is to make contractors to fulfil the tasks and aims to which they have agreed in a chengbao contract.

The relevance of all these factors, however, does not necessarily make all of them chengbao objects. As a matter of fact, these four different views are, to a great extent,

³² For a summary of these views, see Wang and others, supra note 30, p.46.

mutually exclusive, as each emphasizes only one or two aspects. The controversy and complexity of this issue may be explained by two observations. First, the contents of chengbao contracts are varied. Different chengbao contracts may have considerably different expressions of rights and duties of both the contractor and the party that offers the contract. Even within a chengbao contract, many rights and duties are very complex. As analyzed earlier, the imposition on contractors of some non-economic targets and the enjoyment by the party that offers the contract of the right to inspect and supervise have more far-reaching implications than they would in ordinary economic contracts. Accordingly, any single and simplified explanation of contractual objects would seem undesirable.

Secondly, and in my view more importantly, the differing conceptions by a contractor on the one side and by the party that offers the contract on the other have contributed to the difference in views on the nature of the contractual objects. Contractors seek to obtain through chengbao contracts not only the assets of enterprises but also all necessary rights and powers to carry out their operation. They are anxious to avoid administrative intervention by the party that offers the contract. They basically demand the right to possess, use, and dispose of enterprise property, and to do so within legal rather than administrative parameters. On this basis, they carry out the tasks and aims settled in chengbao contracts. In addition, and more significantly, they will attempt to satisfy their own interests, including those of the enterprise managers and the workers.

The party that offers the contract, however, may have a rather different view. Government departments want to make sure that a contractor must first be obliged to fulfil the tasks of a chengbao contract. In order to facilitate the realisation of these tasks, the government devolves on contractors certain powers to manage the enterprise. And the government may choose to encourage contractors, managers and workers by recognising their own interests. On the other hand,

the party that offers the contract still retains rights to intervene on both civil and administrative grounds.

Thus, the contractor and the party that offers the contract may have widely divergent views on the objects at which the rights and duties defined in a chengbao contract are aimed. It should also be clear from the above analysis that a chengbao contract has its own distinctive features which make it different in many important respects from typical economic contract. The complicated nature of the contents of a chengbao contract, the difficulty in defining adequately the principle of equality between the contracting parties, and the differing perception of the two parties as to the objects of the contracts' rights and duties, make the nature of a chengbao contract uncertain. It is unrealistic to ignore the administrative aspect of such contracts. The latter cannot be presumed to be purely civil or economic in nature. This phenomenon becomes more and more controversial in the discussion below.

III. Practical Issues of the Chengbao System

A. Locus standi of the director

In a chengbao contract, the contractor and its manager remain separate. It is the enterprise that is named by the Chengbao Regulations as the contractor.³³ But the enterprise must be managed by a chosen natural person.³⁴ According to the Chengbao Regulations, this person can be selected either through bidding or by appointment from the government authorities although the former is required by law to be given first consideration.³⁵ An enterprise or a conglomerate may bid for a chengbao contract. Having succeeded in the bidding, it must choose a representative to manage the contracted

³³ Art.14.

³⁴ Art.26.

³⁵ Ibid.

enterprise.³⁶ The ways by which managers are selected, and their legal status have been examined in detail in Chapter Six of this thesis. Here the immediate concern is to examine the manners in which enterprise managers have affected the chengbao contracts.

Nominally, a chengbao contract is concluded between relevant government authorities and an enterprise. But, in fact, negotiations for, and the drafting of, such a contract take place at the same time as, if not later than, the selection of the manager. The determination of a manager is a prerequisite for the conclusion of a chengbao contract. It is not popular, although it does sometimes happen, that the selection of a manager falls behind the conclusion of a contract or that a person steps into the position of a removed manager without negotiating for a new contract. Moreover, it is the manager who shall on behalf of the contractor sign a chengbao contract with the party that offers the contract.³⁷ An enterprise manager may select, according to his needs and as prescribed by the relevant rules, a number of people to form a "leading body" (lingdao xiaozu) in the enterprise. And when the chengbao contract expires, this leading body shall be dissolved.³⁸ Thus, the treatment of a manager is vital to the functioning of the chengbao system.

As to the contents of a chengbao contract, it is certain that many rights are enjoyed by, and many duties are imposed on, enterprises as contractors. Indeed, these rights and duties are directly or indirectly associated with managers who, like the enterprises, are deeply involved in a chengbao contract. In addition, a chengbao contract must also state in express terms the rewards and punishments for a manager.³⁹ Such a mixture of interests of both the enterprise (presumably

³⁶ Ibid.

³⁷ Art.14.

³⁸ Art.31.

³⁹ Art.16.

the workers) and its manager, in Chinese government's opinion, serves to "consider jointly the interests of the state, the enterprise, the managers, and the workers, to utilise the enthusiasm of enterprise managers and workers, to tap the potential of enterprise, to safeguard the profits turned over to the state, to strengthen the self-developing power of enterprises and to gradually improve the livelihood of workers".⁴⁰ But this mixture of interests also raises serious problems if there is a failure to fulfil a chengbao contract and a legal dispute develops.

According to the Chengbao Regulations, an enterprise contractor which fails to fulfil a contract is liable for the breach of contract.⁴¹ Moreover, it is also provided that a manager may, in accordance with the seriousness of the circumstances, be investigated and obliged to bear administrative as well as economic liabilities.⁴² By threatening managers with administrative and economic sanctions, the Chinese authorities have displayed their concern over the strict and practical implementation of chengbao contracts.

It might, however, be an exaggeration to hold that such the threat of many liabilities is unique to the managers of chengbao enterprises, since the ECL also contains a similar provision for ordinary economic contracts.⁴³ Nevertheless, as far as liabilities are concerned, a chengbao contract differs from typical economic contracts in at least two respects. One is that, while the liabilities for a party directly responsible for the breach of contract is put by the ECL in the order of "economic, administrative and even criminal",⁴⁴ the manager of a chengbao contractor shall bear

⁴⁰ Art.3.

⁴¹ Art.25.

⁴² Ibid.

⁴³ Art.32, ECL.

⁴⁴ Art.32.

"administrative and economic responsibilities". Thus the priorities and emphasises are different. The other difference lies in that the condition for the imposition of liability in an ordinary contract is clearly defined by the ECL as that "breach of duty, malpractice or other illegal conducts" have caused "serious incident or losses". But the Chengbao Regulations only state that the liabilities may be considered "in view of the seriousness of the circumstances".⁴⁵ And no further explanation is provided. In consideration of these two aspects, it is likely that administrative liabilities are easier to impose on managers of chengbao enterprises. In fact, and more importantly, the most distinguished feature of the chengbao contract is that the party that offers the contract is the contractor's superior authorities. These authorities have the power to impose administrative sanctions on managers of the contractors. This power is absent for parties in most ordinary economic contracts.

In case of a legal dispute, the locus standi issue of contesting parties is controversial. There is no obvious problem for the party that offers the contract, that is, government authorities. But the mixture of interests of the contractors and their managers may cause confusion. In an ordinary economic contract, only the enterprise as the contractor may sue or be sued. The manager of an enterprise is merely the legal representative⁴⁶ of the enterprise. In no case may he be a direct and independent party to a litigation. But the situation in a chengbao contract is quite different. As two Chinese judges have indicated,⁴⁷ there are two contrasting views on the identity of the appropriate party. Some insist that only the contractor, that is, the enterprise,

⁴⁵ Art.25.

⁴⁶ This concept is explored in Chapter Six of the thesis.

⁴⁷ See Jiang Weigang and Lu Shangxu (the Economic Division of the Higher People's Court of Guangxi Zhuang Autonomous Region), "Chengbaofang Chengzufang Susong Zhuti de Queding" (The Determination of Litigant Parties in the Contracts of Chengbao and Zulin), FXPL, No.2, 1990, pp.82-4.

can be the appropriate party to a legal dispute. This puts the manager in the position only as the legal representative of the contractor (as in the case of typical economic contract). The fundamental argument supporting this view is that the party that offers the contract is contracting with the enterprise, not with the manager who should only be in a position to "organise" the enterprise to fulfil a chengbao contract. It is exclusively the enterprise that is dealing with the party that offers the contract. The manager merely has "internal" relations with the enterprise in the respect of management of enterprises and rewards and punishments for his performance. In a word, "it is improper for a manager to join the legal suit in his own name".⁴⁸

This view, however, is opposed by many, including the two judges referred to above. They argue that a manager should have independent locus standi before a court. Their argument is mainly based on the analysis of the reality underlining the chengbao system. This reality can be briefly described as the de facto separation of the person who should be responsible for the contract (that is, the enterprise) and the person who is actually responsible for the contract (that is, the manager). This separation is mainly based on the fact that a chengbao contract is usually devoted to provide for the rights and duties of the manager, not those of the enterprise. "The enterprise as contractor does not bear the responsibility to fulfil the contract tasks, and in contrast, the manager who is not nominally the contractor has actually borne the responsibility of the nominal contractor".⁴⁹ In other words, the enterprise is only the formal contractor, the manager is the de facto executor of the contract. As such, it is the manager, not the enterprise, who should be entitled to sue the defaulting party that offers the contract.

Neither side of the debate is groundless. In my view, to ignore the interests of the managers is unrealistic. On the

⁴⁸ Ibid, at p.82.

⁴⁹ Ibid.

other hand, to deny the locus standi of the enterprise as contractor, by replacing the contractor with the manager, is contrary to the provisions of the Chengbao Regulations.⁵⁰ And such denial is also likely to create difficulties when, for example, the party that offers the contract seeks to hold the whole enterprise as the contractor to be responsible for its failure to fulfil the contract. It is not desirable for the party that offers the contract simply to let the contractor escape from being sued for such a failure, by simply blaming the managers for the breach of contract.

Nevertheless, the recognition of the locus standi of the manager in some cases is bound to succeed. It is the intention of the party that offers the contract that the manager of the contracting enterprise should be bound by the contract. In some cases, allowing the managers the locus standi before a court provides a desirable means for achieving justice. In practice, when the party that offers the contract breaches the contract, if the enterprise as the contractor does not stand to resist such actions, and if the manager is denied the locus standi to bring a legal action, then the manager will not be protected from the government's illegal intrusion which could threaten the performance of the contract. And more importantly, the entire chengbao system may be jeopardised. The truth is that, through a chengbao contract, the party that offers the contract is not only contracting to the contractor but also to a large extent contracting to the managers. The manager is not purely a legal representative of the enterprise but indeed an independent litigant to the legal proceeding in some cases.

As shown in the discussion below, in many cases, the court is ready to recognise the locus standi of managers. In some cases, the court was even so willing as to protect the locus standi of the managers who had been dismissed or removed during the term of chengbao contracts. But this tendency seems to have been stopped. On August 13, 1991, the Supreme People's

⁵⁰ Especially Arts.20 and 25.

Court issued an "Opinion" (pifu)⁵¹ answering an enquiry from the Higher People's Court of Xinjiang Uygur Autonomous Region concerning the locus standi of managers in chengbao disputes. The Opinion instructs that disputes brought by managers in regard to the dismissal or removal of their position should not be accepted by the court. The main arguments which this Opinion was based are: first, managers are the legal representatives of the contracting enterprises; and secondly, such disputes are in nature "disputes concerning personnel matters" (renshi renmian zhengyi).

But at the same time, the Opinion also confirmed that disputes brought by managers in regard to the realisation of incomes recoverable in accordance with the provisions of chengbao contracts should be accepted by the court. As such, the Supreme People's Court attempts to distinguish two types of cases involving managers of chengbao enterprises.

In my view, although it is right that the Opinion supports the locus standi of managers in cases regarding their incomes, the denial of their locus standi in cases regarding their dismissal or removal is hardly justifiable. First, as analyzed above, chengbao contracts are inseparable from managers who are more than merely the legal representatives of the enterprises. They have independent interests which differ from the enterprises as contractors. Secondly, because of the deep involvement of managers, it is not reasonable to make distinctions between disputes concerning the chengbao contracts and disputes concerning pure "personnel matters". Indeed, since managers may rely on the chengbao contracts for protection in their incomes deriving from the contracts, it is unfair that they are denied the judicial access to claim the restoration of their position as managers when the government has breached the contracts by wrongfully dismissing them. In fact, a full guarantee of managers' locus standi in many cases may promote, rather than undermine, the strict performance of

⁵¹ Material collected from the study visit to China in early 1992. This Opinion was published in Hunan Shenpan (Adjudication in Hunan).

the chengbao contracts.

Thus, the denial of locus standi of managers in some cases has little legal justification. The only reason for such denial, it would seem, is that, by keeping the court away from disputes concerning "personnel matters", the administrative authority of government departments is better upheld.

B. Nature of internal chengbao

The main concern of the Chengbao Regulations is the chengbao contracts concluded between the government and the enterprise. Nevertheless, the internal chengbao system within an enterprise is also mentioned. Article 41 provides: "the contractor shall, in accordance with the principle of integrating responsibility, rights and profits, establish and develop the internal economic responsibility system of enterprises and improve their internal chengbao system". In practice, after an enterprise (contractor) has concluded a chengbao contract with the government, a series of sub-chengbao contracts are usually signed between the enterprise and its subordinate workshops, in order to implement the main chengbao contract.

Much like the main chengbao, the nature of the internal chengbao has been subject to debate. While some observers stress the economic dimensions of such contracts,⁵² many are reluctant to place equal emphasis on the importance of both economic and administrative features.⁵³

⁵² See for example Wang Yeqing, "Qiyè Neibu Chengbao Jiufen Chuli Yuanze" (Principles for Handling Disputes Concerning Enterprise's Internal Chengbao Contract), in FX, No.4, 1990, pp.40-2.

⁵³ See a collection of views in Ge Yunying (ed.), "Qiyè Neibu Chengbaozhi Zhong de Falü Wenti" (Legal Issues Concerning Enterprise's Internal Chengbao System), in JJYF, No.6, 1989, pp.5-8. Reproduced in JJF, No.5, 1989, pp.63-6. The editor of this article believes that enterprise internal chengbao contracts, "although having certain nature of administrative operation, generally speaking, can yet be regarded as economic contracts".

An enterprise's internal chengbao presents some distinctive features which differ from enterprise chengbao. First, a sub-contractor does not possess legal personality. A sub-contractor may, in accordance with the contract, have limited power to deal, in its own name and in certain respects, with outside parties. But since a sub-contractor such as a workshop is a constituent part of the enterprise legal person, it can never enjoy powers and assume liabilities in the same way as the main contractor (that is, the party that offers the sub-contract) does. Secondly, sub-contractors are always subject to the administrative control of the enterprises to which they belong. An internal chengbao contract is concluded for the convenience of the enterprise as a whole. The implementation of such a contract may not only rely on, but also be relied on by, another internal chengbao contract between the enterprise and another part of the enterprise. The administrative control exercised by the enterprise is necessary to enforce internal chengbao contracts and to carry out effective operation of the enterprise. Moreover, the enterprise may be held responsible for its sub-contractor's activities, because of the absence of the legal personality of the sub-contractor and of the existence of the enterprise administrative control.⁵⁴

The fact that a chengbao contract does not exclude administrative influences in the internal chengbao system does to some extent help to explain the reason why the main chengbao contract between an enterprise and government authorities has failed to supplant pre-existing administrative relations with purely civil and economic relations. Perhaps, the only difference is that the administrative link is more obvious in a internal chengbao contract than it is in a main chengbao contract.

⁵⁴ It has been blamed by some managers of the enterprises which have been asked to be responsible for the illegal activities such as ultra vires acts of the sub-contractors. See ibid, pp.64-5.

C. Dispute settlement

The settlement of disputes concerning chengbao contracts deserves careful consideration. In practice, both main and internal contracts are likely to be settled in legal and extra-legal ways.

In 1989, about twenty per cent of state enterprises which had practised the chengbao system failed to carry out their chengbao contracts.⁵⁵ There are no statistics available which can be used to analyze in detail the reasons for such striking failure in implementing chengbao contracts. A number of reports and cases suggest that the following reasons are particularly relevant: an unreasonable base figure amount fixed in contracts; unexpected changes in the market, in taxation or in the supply of raw materials or the sale of products; incompetence of managers; and failure by enterprises to increase economic efficiency.

The Chengbao Regulations have provided, in view of different occasions, different remedies for the contracts: readjustment, rescission, arbitration and legal action. These four methods are considered below.

1. Readjustment

Readjustment of a contract is basically an extra-legal device in which the original contract is rewritten. Such a remedy needs mutual agreement by both parties. Article 19 of the Chengbao Regulations states that both parties may propose to make readjustment either when the State Council has effected major changes in tax items, tax rates, and prices of designated schemes products, or in the case of the occurrence of force majeure. In practice,⁵⁶ the reasons for making

⁵⁵ See RMRB, Jul.2, 1990, p.3. But in some provinces and municipalities such as Jiangsu and Beijing, more than ninety per cent of the chengbao enterprises successfully fulfilled contracts. In contrast, in Jiling Province, only 58.6 per cent of enterprises were able to accomplish chengbao contracts.

⁵⁶ See Chengbaozhi Zai Shijian Zhong, supra note 21, p.107.

readjustment may include, inter alia, the change made by the state in the mandatory supply or purchase of goods or products, the removal by the government of managers, and mistakes occurred in the process of negotiating the contracts.

2. Conciliation

The condition for the rescission of a contract lies in the appearance of irresistible forces⁵⁷ and the poor management by the contractors or breach of contract by the party that offers the contract.⁵⁸ Again, as an extra-legal method, rescission needs both parties' consent.

No statistics are available to demonstrate the proportion of defected contracts that have been settled through extra-legal means, that is, by resorting to readjustment and rescission of the contracts. But it is understood that these two methods are very popular.⁵⁹ In practice, the party that offers the contract is more interested in the actual implementation of the chengbao contract than pursuing the contractor's liabilities for failing to fulfil the contract. This is not only because of the ineffective penalties which might be imposed on the enterprise contractors and their managers in case of their failure,⁶⁰ but also because the party that offers the contract may be assessed by its superior government authority in the respect of the percentage of the successful performance by its

⁵⁷ Art.19, par.2.

⁵⁸ See Art.20.

⁵⁹ In 1989, the number of cases which were concerned with chengbao and zulin disputes and which were heard by the court was 6,959. (Information from Ren Jianxin, Work Report of the Supreme People's Court in 1989, see the text in FZRB, Apr.11, 1990, p.2.) Considering that a large number of contracts were not fulfilled and that zulin cases should be excluded from this number, one can imagine that many defaulting contracts have been actually passed off without resorting to legal channels, though many disputes concerning chengbao contracts might be resolved by arbitration held by the ABIC.

⁶⁰ See Arts.25 and 33.

subordinate enterprises of chengbao contracts.

On the other hand, enterprise contractors prefer extra-legal methods. Often, they can escape administrative and legal sanctions. And if they want to keep on good terms with their superior authorities, they choose extra-legal rather than legal channels to resolve conflicts and disputes. The concept of "guanxi" (relations) has always been important in China in resolving conflicts. Law is too weak in front of special relations. Consequently, the institution of readjustment or rescission of original contracts may still be invoked even when the situation falls outside legal provisions. And equally importantly, it is believed that the use of such extra-legal mechanisms is more popular in chengbao contracts than in ordinary economic contracts in which, with the absence of the vertical administrative relationship, one party can hardly tolerate the breach of contract by the other party.

3. Arbitration

In cases where two parties cannot negotiate an agreement to a dispute, one or both parties can, in accordance with a chengbao contract, either go to arbitration or take legal action.⁶¹ The arbitration is carried out by the Administration Bureau for Industry and Commerce (ABIC) at an appropriate level. Until early 1990, the Chengbao Regulations did not make clear the relationship between an arbitration and legal suit in the case of a chengbao dispute. The only legal ground were the provisions in the ECL and the Regulations Concerning Arbitration on Economic Contracts.⁶² According to the ECL,⁶³ a party who is unsatisfied with an arbitration can, within fifteen days after the reception of the award, take legal

⁶¹ Art.21.

⁶² Promulgated by the State Council on Aug.22, 1983. See the text in China's Foreign Economic Legislation, Foreign Languages Press (Beijing) 1986, Vol.II, pp.244-55.

⁶³ See Art.49. Similar provisions are also contained in Art.33 of the Regulations on the Arbitration of Economic Contract, ibid.

action to the people's court; if a legal action does not take place within this period, the award shall have legal effect.

On February 24, 1990, the State Council especially amended the Chengbao Regulations by adding three more paragraphs into Article 21 of the Chengbao Regulations:

If a chengbao management contract does not provide for the method for the handling of a dispute, and if both parties have after the conclusion of the contract, or upon the occurrence of a dispute, reached a written agreement to present a dispute to the ABIC for arbitration, then it is the ABIC who shall have the legitimate right to resolve the case.

Any party who is not satisfied with an arbitration may, within ten days after the reception of the award, apply to the higher arbitration authority for reconsideration. The arbitration award made by this higher authority after reconsideration, or the award which was not applied for reconsideration within the above period of ten days, shall be the final award.

If a party does not implement a reconciliation agreement or an arbitration award which has been legally effective, another party can apply to the people's court for enforcement.⁶⁴

This amendment has made the legal status of arbitration regarding a chengbao contract similar to that concerning a foreign economic contract.⁶⁵ Rather strikingly, it represents a departure from normal domestic economic contract arbitration as mentioned above. In making this departure, the Chinese government has enhanced the authority of ABIC arbitration. Such treatment has certain advantages. The most obvious merit is that it can save time by forcing a contesting party to choose either to go to arbitration or to take legal action, rather than possibly experience the long process from ABIC arbitration to court proceedings. But a far-reaching implication from this special arrangement is that the jurisdiction of the court has been further restricted, and the government as the party that offers the contract can obtain an advantage by inserting into contracts a provision making all

⁶⁴ See the text in FZRB, Mar.2, 1990, p.2.

⁶⁵ See Arts.192 and 193 of the Civil Procedure Law (For Trial Implementation). Also see Art.257 of the new Civil Procedure Law (1991).

disputes subject to arbitration by the ABIC -- another government agency.

4. Litigation

Court proceedings are the last resort in resolving disputes over chengbao contracts. In fact, even before the promulgation of the Chengbao Regulations, the court had been ready to adjudicate such disputes. In contemporary China, of the four chambers which a court is divided -- criminal, civil, economic and administrative, cases concerning chengbao contracts are put under the jurisdiction of the economic chamber. The ECL and the GPCL are the only two relevant legal documents, in addition to the Chengbao Regulations, on which the court can rely. Disputes concerning chengbao contracts are usually resolved in the following three ways:⁶⁶ (1) continuing performance of the contract; (2) a declaration that the contract is void; and (3) alteration or rescission of the contract.

If a chengbao contract has been concluded in accordance with the law and the policy, and if one party has violated the contract while the other has not been found of any serious default, then the court may order the contract to be performed continuously. Such a result may be possibly accompanied by the payment of the default fine and compensation by the defaulting party.⁶⁷

The court's declaration of the nullity and voidness of a chengbao contract is based on Article 7 of the ECL and Article 58 of the GPCL. Generally speaking, the court is willing to do so if a contract falls into one or more of the following situations:⁶⁸ (1) it is contrary to the law, or state policy;

⁶⁶ See Chengbaozhi Zai Shijian Zhong, supra note 21, pp.121-30. Also see Sheng, supra note 29.

⁶⁷ See for example Art.35, ECL.

⁶⁸ See Chengbaozhi Zai Shijian Zhong, supra note 21, p.124. But unfortunately, the author of the above book failed to distinguish a contract which is null and void and a contract which is rescissible. This distinction, which is

(2) it is signed by a person against his true intention as a result of fraud, coercion, or exploitation of his unfavourable situation by the other party; (3) there is lack of authority by one party to conclude the contract; and (4) the contract is contrary to the interests of the state or the social public. Contracts which are null and void shall not be legally binding from the moment when the contracts were signed.⁶⁹

The GPCL distinguishes a civil act which is null and void and that which is rescissible. According to Article 59 of the GPCL, a party shall have the right to request the court or an arbitration agency to alter or rescind the following civil contracts: (a) those performed by an actor who seriously misunderstood the contents of the acts; and (b) those that are obviously unfair. As a rule, rescinded civil act shall be null and void from the very beginning. However, a rescissible civil act (including a contract) is not necessarily null and void. For example, a rescissible chengbao contract is effective unless and until the court has at the request of a party declared its nullity and voidness, despite that upon the court's declaration, the contract is null and void from the moment when it was signed.

The ECL also provides for situations in which an economic contract may be altered or rescinded.⁷⁰ These situations are: (1) when both parties have agreed after negotiation such alteration or rescission which would not damage the state's interests and would not affect the implementation of the state plans; (2) when the state plans upon which the contract was based have been amended or cancelled; (3) when one party has been unable to perform the contract, due to its closure, stoppage of production, or shift on production; (4) when the contract has been unable to be performed, due to the appearance of force majeure or due to an outside reason which

described below in the context of this paragraph, is very important in Chinese contract law.

⁶⁹ Art.7 of the ECL and Art.58 of the GPCL.

⁷⁰ Art.27.

has nothing to do with any party's fault and which cannot be prevented; and (5) when it is not necessary for the contract to be performed because of one party's breach of contract.

These options applicable to different occasions, together with the provisions in the Chengbao Regulations,⁷¹ have founded a relatively comprehensive remedy system in dealing with chengbao contracts. There are at least three points which are worth noting here. First, it seems, although no detailed statistics are available to support it, that most plaintiffs in cases regarding chengbao contracts are contractors, that is, enterprises, and their managers. In other words, a prima facie case would probably be that the party that offers the contract, that is, the government, are alleged to have violated the contract. Such violation can be carried out in many ways, ranging from the removal or dismissal of managers⁷² to the tearing of a contract.⁷³ A common feature of these legal actions is that the party that offers the contract contravenes contractual duties by unilaterally breaching the contract. The contractor, which is in a weak position in its vertical administrative relationship with government authorities, has to rely on the chengbao contract for legal protection.

Secondly, the court has been willing to protect the contractors. Again, there is no statistics to suggest how far the court is ready to go. But it seems that many judges have been guided by the idea that the legal rights and interests of enterprises and their managers must be protected effectively. It is not easy to achieve a fair balance between the interests of the state, the enterprise and their manager. Court decisions in some cases may have to contravene the orthodox view that the interests of the state shall always prevail over

⁷¹ Arts.19 and 20 as analyzed above.

⁷² See Chengbaozhi Zai Shijian Zhong, supra note 21, case 6.11, pp.127-8. However, as shown earlier, due to the Opinion issued by the Supreme People's Court, the managers seem to have been denied the capacity to bring such cases.

⁷³ Ibid., case 6.9, pp.122-23.

those of the collective and the individuals.

For example, in one case, when the government violated a chengbao contract by removing a manager and replacing the existing contract with a new contract,⁷⁴ the court, while denying the possibility for the continuing performance of the original contract because of the changed circumstances, did order the government to pay, in accordance with the provisions of the original contract, a certain amount of bonus to the manager and to pay a significant amount of defaulting fine to both the manager and the workers of the enterprise.

In another case,⁷⁵ the party that offered the contract dismissed the manager because it was not satisfied with the pace of profit increases made by the enterprise in the first six months of the chengbao term. The manager, however, defended the situation by claiming that the fact of low increase at that initial stage was due to his emphasis and massive investment on technological development which would finally contribute to a rapid increase in the subsequent two years of the whole chengbao term. The court found that: (a) the manager did not seriously contravene the law, discipline, or the contract; (b) the increase of the profits was reasonable although it was not at the same pace as the officials had expected; moreover, the contract did not provide that the government could stop the contract under such circumstances; and (c) because of the existence of the legal contract, the government could no longer use its administrative authority to intervene in the enterprise's production. Accordingly, although the court did not order the government to pay a defaulting fine or compensation to the manager, it did declare that the government had violated the contract by committing the ineffective act of dismissing the manager. The court also went further to order the chengbao contract to be continuously performed. In addition, the court

⁷⁴ Ibid. case 6.11, pp.127-28. Again, this case should be read in the light of the Opinion issued by the Supreme People's Court, as discussed earlier.

⁷⁵ Ibid., case 6.9, pp.122-23.

declared that, because of the interruption by the government, that year should not be counted within the entire chengbao term, and therefore the term for that chengbao contract should be postponed for one year.

These cases demonstrate that the court is ready to protect the legal and contractual interests of enterprises and their managers, and to prevent abusive actions taken by government departments in the course of the performance of chengbao contracts. In some cases, the court has gone even further in its attempt to achieve justice by relying on the general provisions of the GPCL. In one case,⁷⁶ when the contract was unfair because the manager failed to check before the conclusion of the contract the base figure amount which was later found to be too high to be fulfilled, the court rescinded the contract.⁷⁷ Afterwards, a new contract was agreed on the basis of a lowered base figure. Such a result is both necessary and desirable in that the terms for a contract must be reasonable to be performed.

Obviously, the making of this kind of protective judgment not only relies on the willingness of the court but also has some practical implications and difficulties. For example, it is arguable whether or not the court should be in a position to judge the reasonableness of the base figure recorded in a chengbao contract. Moreover, it is doubtful whether the court is able to rescind a contract which has been brought into state plans. These complex problems are likely to influence the court's decisions in one way or another.

Thirdly, the court is even ready to deal with disputes concerning an enterprise's internal chengbao contracts. In one case,⁷⁸ the enterprise as the party that offered the contract unilaterally amended an internal chengbao contract, mainly

⁷⁶ Ibid., case 6.10, pp.124-25.

⁷⁷ Again, the author of the book failed to distinguish here a null and void contract and a rescissible contract.

⁷⁸ See Chengbaozhi Zai Shijian Zhong, Supra note 21, case 6.12, pp.128-29.

because it thought the base figure agreed in the original contract was too low. The court, however, found that this was not true. The huge profits made by the sub-contractor had little to do with the low base figure settled in the contract. In fact, the main reason for the alleged significant amount of profits was because the sub-contractor effected good management. Based on these findings, the court upheld the legality of the original contract, and the contractor was therefore given permission to get the amount of the bonus as provided in the contract.

The court's willingness to adjudicate disputes over chengbao contracts by relying on the ECL and the GPCL echoes some academics' claim that chengbao contracts are essentially economic contracts. The court's protection of chengbao contracts can to some extent counteract government administrative intervention. This is admittedly significant when one considers the enormous and totally uncontrolled administrative powers in the hands of government authorities before the chengbao system was introduced.

It is, however, unrealistic to put too much hope on the positive effects that the court adjudication of chengbao contracts may produce. In practice, as indicated in earlier discussion, only a small number of chengbao disputes are settled through court proceedings.⁷⁹ According to a survey conducted in 1987 -- the year when the chengbao system was introduced nationwide, when enterprises were asked about their choices for settling disputes concerning chengbao contracts, 44.2 per cent enterprises would choose to go to their government departments in charge for solutions, 19.9 per cent would choose to go to court for adjudication, 19.1 per cent would choose to go to the ABIC for arbitrations, 7.8 per cent would choose to go to their local governments for settlements, and 7.9 per cent would choose other ways, including not to do

⁷⁹ On the study visit to China in early 1992, when I was trying to get information concerning chengbao disputes, to my surprise, some Chinese judges were even apparently unaware of the occurrence of such cases.

anything.⁸⁰ As such, an overwhelming majority of enterprises would choose not to go to court. Instead, they tend to resort to administrative help from relevant government authorities, including government departments as the party that offers the contract.

In practice, in most cases, it is enterprises that breach chengbao contracts. Nevertheless, as suggested above, potential plaintiffs tend to be enterprises and their managers. It is unlikely, though it might happen, that government departments will pursue legal action in order to hold enterprises and their managers responsible for compensation and other legal remedies. Generally speaking, government departments are willing to forgive enterprises for their failure in carrying out chengbao contracts. This is partly because these government departments, in order to save their own "face", tend to protect their subordinate enterprises. Instead of legal actions, government authorities may prefer to resort to internal negotiation and, sometimes administrative sanctions including dismissing the managers, to resolve disputes and transfer liabilities for chengbao contracts.

In some circumstances, enterprises directors are required to provide personal guarantees to chengbao contracts. If their enterprises fail to fulfil the contract, they may be held liable to pay up to the amount of their personal guarantee. However, as enterprise contractors are subordinate to the government and they do not have their own property apart from the property that "is authorised by the state for them to manage and administer",⁸¹ in many cases, pursuing legal action against defaulting enterprises is not meaningful, not to

⁸⁰ See Xiong Jining, "Zuzhi Gouzao Zhong de Qiyue Falü Xuhua" (Fictional Nature of Legal Contracts Regarding Institutional Structuring, part 1), ZFLT, No.3, 1991, pp.73-6 and 66, at 76.

⁸¹ For a discussion of the property rights of state enterprises, see Chapter Three above. For a discussion of the financial autonomy and the nature of the so-called "enterprise capital", see Chapter Five above.

mention the time-consuming process for legal proceedings.

On the other hand, it is not easy for contractors to insist on their legal rights. This is partly owing to the difficult position of the court in adjudicating chengbao cases, as discussed above. Moreover, contractors themselves may face serious challenge even if it is obvious that the other party has breached the contract. In one of the cases discussed above, despite that the court had upheld the legality of the chengbao contract, after conciliation, the contractor finally agreed to make a concession to the other party by increasing the base figure, which was exactly what the other party sought for by breaching the contract. As such, the final solution proved to be that both parties were the winners.⁸² The fact that the contractor had to give in to the party that offered the contract, to some extent, explains that the vertical administrative relations between the two contracting parties can still be very significant despite the civil and contractual relations between them.

As a matter of fact, the parties that offer the contracts, whether being government authorities or enterprises, can take advantage of their superior positions to manipulate the contractors or sub-contractors even if their actions are apparently abusive. In particular, the contractors (enterprises) have to consider every possible consequence if they do not make concessions to the government as the party that offers the contract.

IV. Contracting and Leasing: Some Comparisons

Like chengbao, zulin (leasing) is also a notable measure employed by the Chinese leadership to reform state

⁸² It is interesting to see that the party that offered the sub-contract, that is, the enterprise, succeed in this case. However, this is no exception. With the involvement of administrative power (held by the enterprise), the weak party (that is, the sub-contractor) has to give in in reconciliation although it has legitimate right to insist on the original contract.

enterprises. In order to regulate the leasing system, on May 18, 1988, the State Council adopted the Provisional Regulations Concerning the Leasing Management of Small State Industrial Enterprises ("Zulin Regulations").⁸³

Zulin and chengbao share many features in common. For example, they are designed to implement the separation of ownership from management. Moreover, both involve formal and legal contracts, which shall last for at least three years.⁸⁴ In addition, some duties and rights are similar as to parties both in a chengbao and in a zulin contract. For example, the lessors, that is, government departments, have both the right to supervise the lessees' activities⁸⁵ and the duty to protect the management rights of the lessees.⁸⁶ The situations where a zulin contract may be altered or rescinded⁸⁷ are also similar to those in a chengbao contract discussed above.

Chengbao and zulin, however, represent many differences⁸⁸ with which the government as the owner of the enterprises has been concerned. First, while chengbao is widely applied to large and medium-sized state enterprises, zulin is restricted to small state enterprises.⁸⁹ Secondly, managers are more deeply involved in zulin contracts than in chengbao contracts. Although a lessee may be an enterprise other than the one to

⁸³ These Regulations were effected from Jul.1, 1988. For the text in Chinese, see Laws and Regulations of the PRC (1988), pp.750-59.

⁸⁴ Art.17 of the Chengbao Regulations and Art.8 of the Zulin Regulations.

⁸⁵ Art.23.

⁸⁶ Art.24.

⁸⁷ Art.20.

⁸⁸ For a general analysis of these differences, see China Law and Practice, No.5, Vol.II, 1988, p.52. For a legal analysis, see Professor Xie Huaishi, "Lun Guoying Qiye Chengbao Hetong Yu Zulin Hetong" (On Chengbao Contracts and Zulin Contracts of State Enterprises), in FXZZ, No.4, 1988, pp.3-5 and 16. Reproduced in JJF, No.1, 1989, pp.47-9.

⁸⁹ Art.2.

be leased, or indeed several individuals in a partnership, in many cases a lessee is an individual.⁹⁰ A manager can be the lessee to a zulin contract. This position of managers contrasts with the situation in a chengbao contract where the law has held that a chengbao contractor must be the enterprise to be contracted, not its manager. Moreover, a zulin manager is entitled to obtain greater profits than a chengbao contractor and its managers. While the annual income of a chengbao manager may be one to three times higher than the average annual income of a worker in the enterprise,⁹¹ the annual income of a zulin manager can be as higher as five times more than the average income of a worker in the leased enterprise.

On the other hand, a zulin manager has to take greater risks than a chengbao manager. According to the Zulin Regulations, a lessee has to provide security.⁹² In case of an individual as a lessee, he has to provide as security such personal property which is proportional to the property of the leased enterprise, including a certain amount of cash which must be deposited at a special bank account. And he has to provide at least two guarantors who have property which may be used as security.⁹³ From the day when a zulin contract is effective, the wages and bonus of the manager and his partners will be stopped, although they can get in-advance-payment of living expenses.⁹⁴ In case of his failure to implement a zulin contract, the lessee and his guarantors will be called to make up the losses.⁹⁵

Thirdly, and more importantly, a lessee and a manager have more powers and rights but less duties than a chengbao

⁹⁰ Art.7.

⁹¹ Art.33.

⁹² Art.11.

⁹³ Art.11, par.1.

⁹⁴ Art.32.

⁹⁵ Art.35.

contractor and its manager. As far as a lessee's duties are concerned, the Zulin Regulations list five items, namely, (1) implementing director's duties which are provided by the state; (2) carrying out state pricing policy and protecting the interests of customers and consumers; (3) protecting the legal interests of workers; (4) protecting the property of the leased enterprise, guaranteeing the good condition of the equipment, making insurance for the enterprise property; and (5) paying rent in due time.⁹⁶ The amount of rent is agreed by both parties before a zulin contract is concluded. Since it is based on the property of the enterprise to be leased, it has little to do with the actual performance of the lessee who has only to hand over a fixed amount of rent to the government. Thus, zulin differs from chengbao in that the state may choose to obtain the amounts of profits which are proportional to the overall profits made by the chengbao enterprise. In addition, a lessee rarely has any non-economic obligation as usually appeared in a chengbao contract. For example, a lessee does not by contract have the duty to invest in technological transformation, though the lessor may give all or some of the rent back to the enterprise and order it to invest in the development of production and technological transformation.⁹⁷

In terms of rights and powers, a lessee is in a more advantageous position than a chengbao contractor and its manager. Under a chengbao contract, the manager can only exercise powers according to the SEL. But a lessee is authorised with more powers. The Zulin Regulations describe the powers of a lessee as: (1) enjoying the director's rights provided by the state; (2) appointing or removing deputy directors, and reporting it to competent authorities for reference; (3) deciding the arrangement of workers released from production; (4) adjusting the operation orientation of the enterprise in accordance with the market, and making the

⁹⁶ Art.26.

⁹⁷ Art.28.

alteration of registration in accordance with the state stipulation.⁹⁸ Thus, a lessee is authorised with a number of powers which are substantially broader than those provided in the SEL.⁹⁹ For example, as far as the personnel power is concerned, a lessee can make his own decisions about the appointment or removal of a deputy director, provided that he shall report this to the competent authority for reference. But according to the SEL,¹⁰⁰ such appointment or removal can only be made by the government authorities at the request of the director. This is very much the case in a chengbao enterprise.

The fact that a lessee may enjoy more powers but bear less duties illustrates that the government has adopted a flexible policy towards small state enterprises. On the other hand, the simple fact that an enterprise is a large or medium-sized one has been used to justify the official policy that it should be subject to more government administrative control.

V. Conclusion

The above discussion has concentrated on the chengbao system in which state enterprises themselves are the contractors. In practice, the implementation of the chengbao system is more complicated. For example, as indicated in the discussion, enterprises other than the enterprises to be contracted can be the contractors. Moreover, not only Chinese citizens may become the managers of chengbao enterprises, for foreigners may also have limited access to serve as managers of a contracted enterprise.¹⁰¹ In addition, many collective

⁹⁸ Art.25.

⁹⁹ For the powers provided by the SEL, see Chapter Six of the thesis.

¹⁰⁰ Art.45. For the position after June 1989, see the discussion in Chapter Six above.

¹⁰¹ For a case that a foreigner contracted for a division of a Chinese state enterprise, see China Law and Practice, Vol.2, No.9, Oct.31, 1988, pp.37-42.

enterprises and some foreign investment enterprises have adopted the legal mechanism similar to the chengbao system in state enterprises.¹⁰²

The chengbao system has been a major vehicle by which the Chinese reformers have attempted to make state enterprises operate more efficiently. This has been carried out by the efforts to settle, through legal and contractual means, the complex relations between state enterprises and the state.

The employment of the legal and contractual means should not be dismissed as completely ineffective. For chengbao contracts have provided a legal basis which can be relied upon by relevant parties, especially the enterprises. To some extent, the court is willing to intervene, in accordance with relevant contractual and legal provisions, in order to achieve justice. This is especially the case when an enterprise manager is involved. Although a manager is not named by the law a contractual party, the court has been drawn to protect his interests by allowing his limited locus standi.

One must not, however, overestimate the effects of the chengbao system. Despite their civil or economic features, chengbao contracts cannot eliminate all administrative overtones. Chengbao contracts do not exclude government intervention in enterprise management. In case of disputes or failure to fulfil chengbao contracts, relevant parties do not often choose to rely on the contracts for a legal settlement. Thus, chengbao contracts are not readily enforceable.

Compared to chengbao contracts, zulin contracts can more effectively cut off the administrative link between the government and enterprises, and between government authorities

¹⁰² On Sept.13, 1990, the Ministry of Foreign Economic Relations and Trade and the State Administrative Bureau for Industry and Commerce jointly promulgated the Provisions Concerning the Contractual Management of Sino-Foreign Joint Ventures. For an English translation of these provisions, see China Law and Practice, Vol.5, No.2, 1991, pp.32-40.

On Apr.13, 1990, the Ministry of Agriculture promulgated the Provisions Concerning the Contracting System on Township Enterprises. For the text in Chinese, see Collection of Company Laws and Regulations, pp.842-48.

and enterprise managers.¹⁰³ This fact shows that in employing the chengbao system to protect enterprise autonomy, the Chinese authorities are half-heartedly, rather than fully-committed.

Chinese officials have been frank enough to admit that there are many problems within the chengbao system. One of the most serious problems is the so-called "short-term behaviour" (duanqi xingwei). As enterprises and their managers tend to explore the greatest financial outcome within a chengbao term, enterprises' long term development which, for example, requires continuous investment in research and technological transformation has been ignored. In addition, some aspects of social and political implications from the chengbao system have become more and more obvious. Actually, government administrative intervention and enterprises' short-term behaviour have been in an inextricable circle. In the opinion of the government authorities, it is because of enterprises' short-term behaviour that they have to intervene civilly and administratively. But enterprises and their managers often blame government intrusion for the failure of the chengbao system. On the one hand, enterprises have not yet bargained for such independence as to resist government intervention. On the other hand, government intervention has been seen as counterproductive. In fact, despite extensive government control, a fair responsibility system within the state enterprise has not been established.

In spite of many existing problems, the Chinese leadership has insisted that the chengbao system and its principles must be firmly upheld in the near future. By the end of 1990, about ninety per cent of the state enterprises which formally practised the chengbao system had renewed their chengbao contracts for a new term of three years. The principles of the chengbao system have also been written into the Eighth Five-Year Plan (1990-1995).

In the long term, however, the future of the current

¹⁰³ The Zulin Regulations do not even provide for any possible administrative sanction against lessee managers.

chengbao system remains uncertain. The current experimentation of the shareholding system may gradually reduce the significance of the chengbao system, though it remains to be seen whether the shareholding system will be able to succeed the existing chengbao system to become the dominant approach in reforming state enterprises.¹⁰⁴

¹⁰⁴ For a brief account of the development and problems with this system, see Chapter Ten below.

CHAPTER TEN

CONCLUSION AND FUTURE PROSPECTS

I. Legal Regulation of State Enterprises: Efforts and Effects

As suggested in the Introduction to this thesis, the legal regulation of Chinese state enterprises can be examined from two main ways. The first is concerned with the efforts made to place state enterprises within a legal, systematic, and regulatory framework. The other is the effectiveness of this legal regulation.

A. Efforts of laws and regulations

In any sense, it is a remarkable historical achievement in the PRC that state enterprises have been made subject to formal legal regulation. Despite the fierce debates involving the formulation, and the time-consuming process for the introduction, of relevant laws and regulations, in particular the SEL (April 1988), Chinese state enterprises, from formation and registration to bankruptcy and liquidation, and from management to workers' participation, have been placed within a legal framework. Moreover, seen as a whole, this framework has been carefully prepared and is relatively consistent.

As has been shown in this study, the legal framework governing state enterprises has been constructed in a variety of ways. As a starting point, the state enterprise has been granted legal personality, something inconceivable for Chinese state enterprises before economic reforms. The legal person status conferred on state enterprises was seen by many as a fundamental mechanism for generating many other positive

developments. The most important of these was that state enterprises as legal persons would be able to enjoy independent interests and to defend their autonomy against excessive government intervention. Furthermore, in the view of the Chinese authorities, state enterprises as legal persons should be fully responsible for their own management. State enterprises which continue to be poorly managed would be threatened with bankruptcy.

Concurrent with these efforts to give enterprises an external corporate personality is the legal reform of the internal leadership structure of state enterprises. In order to establish the director responsibility system, the role of enterprise Party organisations had to be played down. This reform was confirmed in the SEL. In addition, in the process of reallocating powers within state enterprises, the issue of worker participation in enterprise management received legal treatment, thereby adding weight to its ideological and political significance.

In constructing the legal framework governing state enterprises, a central concept has been developed and gained wide acceptance. This is the so-called "management right" of state enterprises which was confirmed in principle by the GPCL of 1986 and subsequently substantiated by the SEL of 1988.¹ This concept was considered by many as sufficient for providing state enterprises with adequate autonomy and responsibility. It was hoped in particular that the management rights would help to settle the relationship between the government and state enterprises -- a subject of the greatest concern for state enterprise reform.

Since 1987, in an attempt to honour the promise of management rights to state enterprises, the contracting or chengbao system has been practised in the great majority of large and medium-sized state enterprises. By requiring state enterprises to conclude legal contracts with government departments, it was hoped that the chengbao system would not

¹ See Chapters Three and Four above.

only enhance enterprise autonomy but also bring fundamental changes to the enterprise -- government relationship. The use of such a contractual mechanism in China has been a major solution to the problem of enterprise autonomy in the ongoing economic reforms of socialist systems over the past decade or so.

B. Effects of laws and regulations

1. Practical analysis

This emerging legal framework has had both positive and negative effects. On the one hand, state enterprises have under written laws obtained a certain degree of autonomy and independence. As legal persons, they enjoy the freedom to deal with many other entities independently. They have also been put in a position to assume independent civil liability.

On the other hand, the effects of such legal efforts are not without problems. As shown in Chapter Nine, the chengbao system has failed to guarantee the management rights of state enterprises. Notwithstanding the existence of formal legal contracts concluded between governmental bodies and state enterprises possessing legal personality, various government authorities still tend to intervene in enterprise management, adding immensely to the difficulties of management autonomy in state enterprises. In addition, the contracting system has failed to make state enterprises genuinely responsible for their management. In fact, the contract used in the existing chengbao system is not readily enforceable.

The unsatisfactory implementation of the contracting system is just one example of the many unfortunate failures in the overall legal regulation of state enterprises. As demonstrated in Chapter Five, tax regulations were introduced in the early 1980s as a means for establishing the financial relationship between the state and state enterprises. However, these regulations have been made redundant as a result of the implementation of the contracting system which emphasizes negotiable profit payments, rather than rigid tax payments, in

the assessment of the performance of state enterprises. Moreover, proper enforcement of the legal provisions concerning workers' participation in enterprise management remains difficult. In addition, and most significantly, the autonomy of state enterprises, as formally recorded by the SEL, has not been given serious respect by many government authorities.

2. Comparative view

The legal regulation of state or public enterprises in any country is not an easy task. As early as 1967, the Report of United Nations Seminar on Organisation and Administration of Public Enterprises concluded that:

At the very least, the law relating to a public enterprise will provide its management with certain opportunities (which may or may not be taken) and will impose certain restrictions upon it which may or may not be of an appropriate kind. Legally imposed restrictions may indeed be crippling; and until they are removed or modified, management may find it quite impossible to achieve an adequate standard of commercial operation.²

This is precisely what has happened in China. Although laws and regulations have been promulgated to promote the autonomy of state enterprises, they are not as effective as one would have expected. In fact, state enterprises are still in a weak position vis-a-vis government manipulation.

As indicated in the thesis, Chinese state enterprise reform and indeed the economic reforms as a whole were greatly inspired and influenced by the economic reforms which had taken place from the 1960s on in the Soviet Union and Eastern Europe. In many respects, Chinese reformers either copied or learned from the experiences of these socialist countries. The concept of "management right", which originated in the USSR and developed in some Eastern European countries, is the best example of this adaptation process. However, state enterprise reform in the USSR and Eastern Europe did not succeed.

² United Nations, Report of the United Nations Seminar on Organisation and Administration of Public Enterprises, 9 ST/TAO/M/39.

Although much legislation was adopted to authorise autonomy for state enterprises,³ state enterprises were not put in a position to enjoy the freedom and independence that was necessary for them to carry out efficient decision-making and production.

Let us take the former USSR as an example. Although the reform of Soviet state enterprise started in the 1960s, a comprehensive law on state enterprises was not published until 1987.⁴ Indeed, it was widely acknowledged that earlier efforts to authorise state enterprises with autonomy largely failed.⁵ Furthermore, one analysis of the Law on the State Enterprise (Association) of 1987 (and as amended in 1989) suggests that the enacted statute has "disappointed proponents of perestroika".⁶ The existence of many restrictions and outside difficulties meant that the autonomy of state enterprises

³ For a review, see Hubert Izbebski, "Legal Aspects of Economic Reforms in Socialist countries", American Journal of Comparative Law, 1989, pp.703-52, at 723-27.

⁴ In 1965, Regulations on the Socialist State-Owned Production Enterprise were adopted. In 1974, Regulations on the Production Association (Combined Works) were adopted. However, these were to a certain extent administrative regulations. In fact, the proposal to enact a formal law on state enterprises was not made until about 1985. Finally, the Law on the State Enterprise (Associations) was adopted on Jun.30, 1987. This law was later amended on Aug.3, 1989. For the English text of the amended law, see Serge L. Levitsky (ed.), Soviet Statutes and Decisions (A Journal of Translations), published by M.E. Sharpe, Summer 1990, pp.19-66.

⁵ Professor V.V. Laptev, a leading Soviet lawyer on Economic Law, was quoted as saying in 1986 that "the idea of expanding the rights of enterprises and associations is not a new one. There have been numerous attempts at its implementation. However, departmental rules and regulations, in essence, have reduced these attempts to nothing." See Satnnslaw Pomorski, "The Future of the State Enterprise and the 'Restructuring' of the national Economic in the USSR", Tulane Law Review, 1987, pp.1383-95, at 1386.

⁶ See Paul B. Stephan III, "Soviet Economic Law: The Paradox of Perestroika", University of Pittsburgh Centre for Russian and East European Studies 1990, at 37.

under the new law was neither radical nor practical.

Compared to the past experiences in the Soviet Union and Eastern Europe, the reform of state enterprises in China has several special features. For example, Chinese state enterprises face a more complicated supervision system in which there is often more than one government department in charge of a single enterprise. Moreover, unlike some former Eastern European countries, such as Yugoslavia, where the law expressly granted property ownership to state enterprises, Chinese law has refused to allow any kind of division in the exclusive state ownership of state enterprises. In addition, Chinese state enterprises have not universally adopted the self-management system in which the workers' assemblies or other similar organisations may exercise many decision-making powers in relation to the management of state enterprises.

Nevertheless, the legal regulation of state enterprises seems to suffer similar predicaments in most socialist jurisdictions. In fact, the lack of autonomy is not peculiar to socialist state enterprises. In many Western countries, state enterprises are also widely noted for their vulnerability to government intervention and manipulation.⁷ Perhaps the only major difference between socialist and Western countries is that state enterprises occupy a more important position in socialist economies. Accordingly, the failure of a policy of enterprise autonomy can be more damaging to socialist economies and create more frustration to the policy-makers.

In the Chinese context, it is interesting to recall the situation of the late Qing Dynasty. As reviewed in Chapter Two of this study, in the late nineteenth century, many modern enterprises were first established by the Qing government. However, the official administration of enterprises made efficient management impossible. In fact, the inefficiency of

⁷ For an assessment of British state enterprises, see Tony Proser, Nationalised Industries and Public Control (Legal, Constitutional and Political Issues), Basil Blackwell (Oxford and New York) 1986. Also see Chapter Four above.

government enterprises was so deep-rooted that mere privatisation, in the form of either joint operation by government and merchants or operation by merchants under the supervision of government officials, failed to resolve it. Even the promulgation of company law could do little to help merchants obtain management autonomy.⁸

In fact, the ineffective legal regulation of state enterprises even contrasts with contemporary legal regimes governing other enterprises. Despite the fact that these different legal regimes started at the same time and have operated under the same social, economic and political systems, it is generally acknowledged that laws and regulations governing other enterprises, especially foreign investment enterprises, are more thoroughly applied in practice than those governing state enterprises. Other enterprises also enjoy a greater degree of management autonomy.

II. Laws and Policies in State Enterprises

Over the past four years (1988-1992), the laws and regulations governing state enterprises have proved to be one of those legal sectors which have been least respected and worst implemented since China renewed its legal reforms in the late 1970s. This fact is not only recognised by most state enterprise managers, but also widely acknowledged by the leadership. Since 1991, considerable attention has been paid to the need for the full implementation of relevant laws and regulations. The official call for a better implementation of the SEL has been echoed by many walks of society, including legal press.⁹

A number of reasons have been suggested to explain the

⁸ For an analysis, see Albert Feuerwerker, China's Early Industrialisation: Sheng Hsuan-Huai (1844-1916) and Mandarin Enterprises, Harvard University Press (Massachusetts) 1968.

⁹ See, for example, two special editorials published in FZRB, Feb.21, 1992, both at 1.

ineffective and disappointing implementation of the legal regulation of state enterprises in China.¹⁰ For example, after reviewing the impact of legal institutions on economic reforms in China, Donald Clarke concludes that "passing laws is not enough. Statutes can be effective only within an appropriate institutional framework".¹¹ He further argues that "the content of reform policy is inseparable from the vehicle in which it is expressed" and that "without a fundamental reform of the legal system, which in many ways has yet to be accomplished, thorough industrial reform cannot be achieved."¹²

These remarks, which to a great extent coincide with complaints made by many Chinese observers, certainly fit the PRC case. As demonstrated in the discussion throughout this thesis, the ineffective application of laws and regulations is partly due to the unsatisfactory performance of law enforcement agencies, including the courts and relevant government authorities. As shown in Chapter Four, many government departments tend to ignore legal provisions and intervene in enterprise management. Moreover, as shown in Chapters Four and Nine, the court is not in a position in

¹⁰ For a summary of a seminar commemorating the third anniversary of implementation of the SEL, organised by the Legislative Committee under the NPC, the State Economic System Reform Commission, the Production Office under the State Council, and the China Association of Entrepreneurs, see Lu Mu, "Dazhongxing Qiye Chongzhen Xiongfeng Zhi Dao" (The Way to Restore the Prestige of Large and Medium-sized State Enterprises), in RMRB, Sept.23, 1991, at 2. This report gave several reasons for the poor enforcement of the SEL. They included the lack of authority of the SEL, the lack of independence by enterprises, and the fear of enterprises in defending their autonomy.

In addition, it is clear from the materials I read when I was visiting China in early 1992, that several officials who attended that Seminar also raised the issue of the lack of appropriate and special enforcement institutions as an important reason for the failure to apply the SEL.

¹¹ Donald Clarke, "What's Law Got to Do with it? Legal Institutions and Economic Reform in China", UCLA Pacific Basin Law Journal, No.1, Fall 1991, pp.1-76, at 3.

¹² Ibid.

which it can play an active role in protecting the autonomy and interests of enterprises.

Institutional design can be very important in the appropriate enforcement of relevant laws and regulations. Indeed, as demonstrated in this thesis, the legal framework governing state enterprises did give extensive attention to both internal and external institutional design. The legal personality of state enterprises, contracting system, director responsibility system, and worker -- staff congresses (WSC) are all examples of legal institutions employed by the Chinese leadership to facilitate state enterprise reform. However, these institutions do not work well. For example, the contract as used in the chengbao system has in many cases lost its essence as a legally enforceable contract.

In addition, as Clarke points out, there exists the difficulty in formulating and enforcing general and legal rules. The main obstacles lie in the proper treatment of both special situations and distorting effect of political and local power when general legal rules are formulated and implemented. This is best seen in the immense difficulty experienced in making bankruptcy rules applicable to state enterprises. In enacting the EBL, the fundamental aim to promote enterprise economy efficiency was significantly undermined by the need to protect enterprises whose loss-making is mainly due to unfavourable outside conditions such as irrational pricing policy. Furthermore, the EBL gives relevant government departments very considerable discretionary powers to decide the fate of insolvent enterprises. Inevitably, this undermines the jurisdiction of the court.

In fact, poor enforcement of general and legal rules and inappropriate design of legal institutions are just the tip of the iceberg in the complex of problems facing the legal regulation of state enterprises in China. To a great extent, legal and institutional designs are an issue of choice. Although such designs, either defective or sound, are primarily made by the leadership, the execution of these

designs has to depend on the willingness of both the law-breakers and their victims. This is demonstrated by the poor enforcement of the institution of legal proceedings. As demonstrated in Chapter Nine, in adjudicating disputes concerned with the chengbao system, the courts have displayed an enthusiast willingness to protect the interests of enterprises and their managers. However, the reality is that the courts cannot play an active role because their jurisdiction is very limited, and because enterprises, which have to be concerned with their overall and long-term interests, are too frightened to bring government departments to court. For similar reasons, the institution of administrative litigation, which was designed by the leadership for protecting enterprises from government intervention, has never actually been resorted to, despite the fact that enterprises' legal autonomy is frequently infringed by the government. In addition, government departments are unwilling to confront subordinate enterprises in court.

Thus, in examining the effects of legal framework governing state enterprises, the approach from legal institutions and legal rules is helpful, but far from adequate. Indeed, it is necessary, as a first step, to analyze relevant laws and regulations from the nature and interactions of laws and policies.

A. Essence and limits of law

Despite the promulgation of many laws and regulations, tremendous difficulties remain in ascertaining and identifying the rules which are actually applicable.

Different ministries and localities can, and do, play different roles in shaping the specific contents of the laws and regulations. This thesis does not discuss in great detail the issue of regional and industrial variations in legislation, but this problem is very important in the Chinese

context.¹³ For general purposes, it is sufficient to point out that the legal and actual autonomy of state enterprises varies from region to region and even from enterprise to enterprise.

Because the laws and regulations governing state enterprises tend to be loose and ambiguous, they are either readily restricted by, or only to be interpreted and enforced by reference to, other administrative instructions or state policies. For example, as we saw in Chapter Four, the authorization by the SEL of the rights and autonomy to state enterprises was deliberately qualified by many restrictions such as "in accordance with the stipulations made by the State Council" and "unless the law provides otherwise". This cautious approach left great room for administrative and policy instructions to play a major role. As a result, enterprises' legal rights could be easily restricted, or effectively preempted, by various government authorities.

Administrative manipulation is a pervasive fact of life in the legal regulation of state enterprises in China. For example, although the SEL provides that enterprise directors may be either appointed by government departments in charge of enterprises, or elected by the WSCs, in practice most directors are appointed by the government. Moreover, even those directors who are elected by the WSCs have to be approved by the government departments. In fact, as shown in Chapter Nine, many directors designated "directors" by chengbao contracts have nevertheless been dismissed by the government as a purely "administrative and personnel matter" which falls out of court jurisdiction. Accordingly, they are prevented from resorting to law and contract for protection.

To a great extent, laws and regulations governing state enterprises are simply a pulling together of relevant pre-existing practices through which the administrative control of state enterprises was (and to some extent still is) exercised.

¹³ For example, in coastal areas and Special Economic Zones, state enterprises which have to compete with other enterprises may actually have more freedom in their decision-making process. For a general discussion of the local and regional powers, see Clarke, ibid.

The legal regulation of state enterprises bears distinctive administrative features which make the laws nominally clear but very uncertain in actual content. This factor enables and indeed encourages government departments to shut their eyes and abuse their authority as if there were no laws. In fact, as shown in Chapter Eight, despite the adoption of the EBL, liquidation of insolvent companies continued to be dealt with in accordance with previous practice and new government instructions which simply ignore and even contradict in places the provisions of the EBL.

In fact, this uncertainty in the laws and regulations is further exacerbated by the fact that legal provisions are profoundly policy-oriented. Policies tend to drive and direct the legal regulation of state enterprises.

First, the law itself is not clear but **must** rely on state and party policies for clarification. This is best illustrated by reference to the director responsibility system. Although the SEL sets out the "central position" of directors and managers in state enterprises, the powers and authority of these functionaries are not self-evident. In particular, it is very difficult to identify the role of party organisations. The latter used to dominate the decision-making of the state enterprises under the pre-reform enterprise leadership system. As a result of these limitations in the SEL, it is necessary to consult relevant documents issued by the party to discover the roles which are supposed to be played respectively by the party secretaries and the directors under the new system as confirmed by the SEL.

Secondly, although policies may prove to be the main force advancing the development of the laws and regulations, they may also create significant limitations in the formulation of laws and legal concepts. For example, the dominant policy of promoting the independence of state enterprises has resulted in the legal authorization of legal personality for state enterprises. However, this was done without a resolute and satisfactory treatment of property rights. State enterprises are legal persons but they are not

allowed to enjoy property ownership. It is largely due to this failure that they are unable to defend their own interests against the intervention of government authorities representing the state as the legal owner.

Thirdly, many of the laws and other legal provisions which have been adopted continue to be put aside when they prove inconvenient. For example, as shown in Chapter Eight, the EBL has remained a "paper tiger" -- despite its cautious approach and restrictive wording. The Chinese authorities have been unwilling to enforce the law even in its present "politically" less controversial form. The main problem worrying the authorities is believed to be the threat of unemployment and social instability that would come with a vigorous implementation of the law. These worries were actually admitted publicly before the adoption of the EBL in 1986.

In addition, policy factors also lead to some technical problems in the formulation of laws and regulations. Thus, the inadequate protection of creditors' interests in the EBL is undeniably due to the overriding government policy which defines this law as being primarily concerned with "invigorating" state enterprises. This is mainly because the underlying preference at the time of the drafting of the EBL was to protect the interests of state enterprises as debtors. Moreover, the policy to enhance the authority of enterprise directors has been accompanied by the unfortunate fact that the duties of directors are not adequately developed by law.

B. Features of policies

As outlined above, the fact that legal provisions are often loose and vague means that they have to be interpreted and enforced by reference to state and party policies.¹⁴ If such policies are certain, clearly pronounced, and well documented, then they would be a useful guide to the laws and

¹⁴ For a brief comment on this feature, see Henry Zheng, China's Civil and Commercial Law, at 13.

regulations. However, our research has shown that it is extremely difficult to identify properly, and to state clearly, those policies relevant for the interpretation and enforcement of laws and regulations.

In essence, the legal framework governing state enterprises was built on the general policy of three "separations": separation of government administration from business management, separation of the ownership from management, and the separation of the functions of the Party from those of the enterprise business operation. However, despite various attempts to clarify this general policy, its exact meaning has remained unclear and proved difficult to identify.

The uncertainty of policies is further complicated by the existence of different and usually competing policies. The difficulty in identifying the applicable policy cause particular problems for any objective assessment of the legal regulation of state enterprises. As indicated in the Introduction to this study, it has been contended by some experts that in studying Chinese law it is necessary to search for the "functions" played by relevant legal institutions and legal concepts.¹⁵ No doubt, this approach, accompanied by an emphasis on the social context of law, is very helpful in examining the role of law in all legal systems, especially newly-established or recently revived systems such as in the Chinese case. Nevertheless, it is necessary to be cautious in applying this approach for analyzing laws and regulations of the Chinese economic reforms because many legal rules remain unsettled in their orientation. The dominance of policy considerations -- which usually have to take into consideration many conflicting factors -- makes it difficult to distinguish the "intended" functions from the "unintended" functions of relevant legal institutions.

¹⁵ See, for example, Stanley Lubman, "Studying Chinese Law: Limits, Possibilities and Strategy", in American Journal of Comparative Law, No.2, Spring 1991, pp.293-341, especially at 328-33.

One such example is the EBL. Many potential functions compete with one another, adding immense problems for assessing the functions of this Law. If the economic purpose of this Law is assumed -- as the EBL itself declares -- to be "invigorating state enterprises", then the EBL should be applied seriously and enterprises forced to perform more effectively through the approach of "killing the chicken in order to frighten the monkey" (sha ji xia hou).¹⁶ It is clear that the social and political consideration of the Chinese authorities has superseded the economic and legal functions of the Law. In fact, despite the adoption of the Law, its ineffective functioning cannot be dismissed as "unintended" because as indicated in Chapter Eight, even at the time of the adoption of this Law, it was predicted that the cases involving the bankruptcy of state enterprises would be "few" -- though it was, and still is, unclear how "few" would be acceptable.

In fact, the policies which inform the interpretation and enforcement of laws and regulations are easily changed, making the law very uncertain. This is evidenced by the director responsibility system. As noted above, dominant party policy at the time of the promulgation of the SEL did help to strengthen the authority of state enterprise directors. But the policy adopted after June 1989 has weakened the supremacy of enterprise directors by restoring the "political core" position of party organisations. The official call is for harmonious cooperation between enterprise directors and party secretaries, but, in reality, the law concerning the enterprise leadership system has been made even more uncertain by this revival of the role of party secretaries.

III. Legal and Economic Reforms: Interactions and Limitations

The legal regulation of Chinese state enterprises provides a good case study of the role of law in socialist

¹⁶ That is, to punish someone as a warning to others.

economic reforms. As discussed in Chapter Two, when Deng Xiaoping proposed in late 1978 the enactment of a number of laws, his main concern was that law would bring stability and certainty by preventing policy changes. Since the mid-1980s, the Chinese leadership has accepted that in pursuing economic reforms law should be used to record and defend the achievements of the reforms.¹⁷ Furthermore, since the mid-1980s, a number of Chinese lawyers have cried for radical legal reforms. In their view,¹⁸ in order to achieve final success, laws and regulations must be employed to guide, consolidate, advance, and defend reforms. In particular, legal reforms must be aimed at establishing the rule of law in every part of the Chinese society, including enterprises.

Our study, however, shows that there have been, and still are, tremendous difficulties in carrying out meaningful legal reforms.

A. Pluralism and the rule of law

It is widely believed in the West that political pluralism is a precondition for the rule of law. In other words, the rule of law is impossible if there is not a pluralistic legal order in which entities of different interests can compete effectively and lawfully with one

¹⁷ For example, in 1987, the Thirteenth Congress of the CCP, in its Report, declared that "we must on the one hand concentrate on construction and reforms, and on the other pay attention to the legal system. The building of the legal system must be carried out throughout the reform. ... The building of the legal system must protect the order for the construction and reforms, and must consolidate the achievements made in the reforms. Those which must be promoted or reformed must be clarified by law or institution as far as possible." See Fazhang Shehui Zhuyi Minzhu, Jianquan Shehui Zhuyi Fazhi -- Youquan Zhongyao Lunshu Huibian (Developing Socialist Democracy and Perfecting Socialist Legal System -- A Collection of Important Remarks), Law Press 1988, p.262.

¹⁸ See, for example, Wang Jiafu, Liu Hainian and Li Buyun, "Lun Fazhi Gaige" (On Legal Reforms), FXYJ, No.2, 1989, pp.1-9.

another.¹⁹ In this sense, despite the promulgation of a number of laws and regulations, the rule of law has never been extended to Chinese state enterprises.

It must be admitted that in the post-Mao reform era, attempts have been made to adjust different interests involving state enterprises. However, these attempts are half-hearted and not workable. First, the nature of relevant rights is not clearly defined by law. Nor is the extent of these rights. This is demonstrated by the uncertainty of the management rights. Secondly, the law is not fully prepared to set coherent legal rules for the effective protection of different and often conflicting interests.²⁰ For example, as revealed in Chapter Six, because state enterprises are prohibited from enjoying full property ownership rights, it is impossible to define and identify the "interests of state enterprises" in law. Moreover, enterprise directors have to represent, as a priority, the interests of the state and government departments which appoint, and can subsequently remove, them. In addition, whilst workers' right to participate in enterprise management is guaranteed by law, violation of this right is widespread and little legal liability is invoked for such violation.

Because the law has not clarified relevant rights and

¹⁹ For an analysis, see Richard Baum, "Modernisation and Legal Reform in Post-Mao China: The Rebirth of Socialist Legality", Studies in Comparative Communism, Summer 1986, pp.69-103. This article concerns primarily constitutional and public law. After reviewing the PRC experience of law and comparing the Chinese view with Western conceptions of the rule of law, Baum concluded that "great caution must be exercised in assessing the long-term political implication of China's post-Mao legal order. Although incipient pluralism seems to have made significant headway in recent years, it rests upon an extremely thin political foundation, one that is highly vulnerable to the vicissitudes of endless factionalism and feudal-style bureaucratism that have long been the hallmarks of the Chinese political system." (p.103)

²⁰ This is also a problem for future Chinese company law. Standard documents which have been promulgated as guidance for the reforms of limited companies (see Chapter One, "companies") do not contain any provision for the protection of minority shareholders.

interests, it has failed to create a pluralistic environment. As a result, the parties involved are not willing seriously to insist on their rights and defend their interests -- even if these rights and interests can be accurately identified. In situations of conflict and disputes, laws and regulations are seldom regarded by relevant parties as the best resort for settling their differences. This is most evident in the case of the chengbao system. Neither the government, nor the enterprises, nor the workers, are interested in bringing a legal action against the party which has broken a chengbao contract. Also, although relevant laws grant state enterprises the right to bring administrative litigation against government departments which have infringed their management autonomy, such a case has never actually taken place.

In fact, relevant legal provisions have been heavily politicised and policy-oriented. The Chinese authorities have always asserted that the interests of the state, enterprises, and individuals are consistent. It is also advocated that as the reforms inevitably affect the interests of one party or another, every party must be prepared to take the situation as a whole into consideration. However, the "harmony" among different interests has been bought at the price of laws and regulations losing their sharpness and effectiveness. Being made largely "voluntary" and arbitrary, laws and regulations can hardly offer effective protection to different parties. In the end, not only the enterprises, their managers and workers, but also the state suffers from the ineffective implementation of the laws and regulations. The only beneficiaries, it would seem, are government departments which can ignore legal provisions, continue to enjoy great discretionary power, and intervene frequently in enterprise management.

Therefore, within state enterprises, the rule of law does not yet exist. To a great extent, there is not even a "rule by law"²¹ as laws and regulations are vague and not

²¹ In the Chinese context, "rule of law" and "rule by law" share the same Chinese pronunciation (fazhi) but have quite different meanings. After fierce debates in the early 1980s,

comprehensive. In fact, state enterprises are essentially ruled by policies which have an overriding force in the enactment and implementation of laws and regulations. To a great extent, the rule by policy allows great discretion in the enforcement of laws and regulations.

B. Limits of the legal reforms

Since 1979, a large number of laws have been promulgated in the PRC.²² A new legal system is taking shape. Even in the months following the tragedy of June 1989, most observers agree that unlike the situation that prevailed before and during the Cultural Revolution, there remains hope for the contemporary Chinese legal system. This legal system is fragile but has not totally lost ground.²³

With reference to the above mentioned call made by Chinese scholars for legal reforms, it must be admitted that law has performed mixed functions. First, the "guidance" role of law is relevant but not very apparent. Over the past decade or so, Chinese economic legislation tends to fall behind,

most Chinese lawyers agree that while "rule of law" (法治) represents the ultimate aim of the legal reforms and legal systems, "rule by law" (法制) only signifies the existence of laws and regulations. It seems that the Chinese authorities are more interested in "rule by law", whereas scholars prefer the establishment of "rule of law". To a great extent, "rule by law" has been used in post-Mao China to contrast with the previous experience of "rule by man" (renzhi, 人治) whereby law was largely ignored, and changeable policies prevailed.

²² Until mid-1992, the NPC and its Standing Committee had adopted 117 laws, of which sixty-five are directly related to the economy. See a report in RMRB, Jun.20, 1992, p.4.

²³ See, for example, Jerome Alan Cohen, "Tiananmen and the Rule of Law", in George Hicks (ed.), The Broken Mirror: China After Tiananmen, Longman Group UK Limited 1990, pp.323-44. Also see Gellat, "Law Reform in the PRC After June 4," Journal of Chinese Law, Fall 1989, pp.317-25.

rather than exist to "lead", reforms.²⁴ The usual practice follows the road of reform experimentation (based upon policies), formal legislation (whether tentative or not), and widespread reforms. Both the SEL and the Chengbao Regulations are examples of this process, though one exception is the EBL which was adopted in 1986 with little prior experimentation.²⁵

Secondly, the "consolidating" or "recording" function of law is widely recognised as more important. To a great extent, laws and regulations are able to summarize experimental experience and record legal rules and concepts which are regarded by the leadership as valuable and worthy of broader application. In the case of state enterprises, management rights, director responsibility system, and chengbao system are all examples of the "recording" role of law.

Thirdly, the role of law in "advancing" reforms is not fully realised. As legislation tends to lag behind reforms, the advancement function of law is very limited. It is true that laws and regulations may promote further reforms by stipulating general rules for wider application. However, what they record is often past experience and achievement. Although such experience may prove valuable for future reforms, there is a possibility that further reforms will, as a matter of policy shifts, either retreat from or surpass adopted laws and

²⁴ Since the mid-1980s, within China, it is argued that legislation, especially economic legislation should have "the feature of leading effect" (chaoqian xing). That means the law should be enacted before the object to be regulated is fully developed, in order to ensure the standardized development of this object. However, so far, there is no consensus among Chinese decision-makers as to this issue. The lack of the leading effects of law is even acknowledged by the Chinese leadership. The promulgation of many laws, especially a Company Law, continues to be delayed. For a description, see supra note 22.

²⁵ As shown in Chapter Eight, before the adoption of the EBL, only a few collective enterprises were experimented with bankruptcy. Not a single state enterprise was declared bankruptcy before 1986. Interestingly, although the promulgation of the EBL was a bold experiment in legal reforms, the EBL itself has failed to "lead" a widespread bankruptcy reforms.

regulations. This is especially the case as post-Mao reforms have proceeded on the basis of the belief in "touching the stones at the bottom of a river to cross the river" (mozhe shitou guohe), and therefore lacking a radical or determined orientation.

Last, the "defending" role of law in economic reforms is very doubtful. As shown in Chapter Six, to some extent, written provisions of the SEL concerning the director responsibility system did play a role by preventing an emotional policy reversal in the aftermaths of June 1989. However, political considerations were so overriding that significant policy changes were carried out at the coast of legal certainty. Despite that written legal provisions remained unamended, they had to be understood and implemented quite differently. As a result, the law has failed to defend the achievements in radically reforming the enterprise leadership system.

To some extent, the failure of legal reforms can be attributed to the contradiction between law and reforms. Essentially, law seeks stability and certainty, and therefore tends to be conservative. But reforms are aimed at development. The contradiction between relative certainty and rapid development is not easy to solve. Although laws and regulations may add more authority and enforceability to reform policies, it is very doubtful whether or not laws and regulations can actively "guide" or "advance" reforms. In particular, given the uncertainty of reforms, it seems impossible to make laws and regulations which are able to bring certainty and to allow flexibility for future reforms.

On the other hand, the factor of the contradiction of laws and regulations, though being very helpful, does not fully explain the reasons for the limits of laws and regulations. In fact, in order to further understand the inherent limits of legal reform, it is necessary to examine the theory of law and its impact on economic reforms.

In the PRC, law is officially regarded as a kind of

instrument.²⁶ In our case, the "instrumentality" view of law is evident in that a legal framework has been constructed to "invigorate state enterprises". Accordingly, laws and regulations themselves are not the end. As indicated by one observer, in China, "law (often, party decisions) is frequently seen as a means to promote economic change or development, and not as something that develops as a result of changes elsewhere".²⁷

The official perception of the instrumental role of law has caused many serious problems. First, law and policy are used together. As instrumentalities, laws and regulations are inferior to policies. Policies used to be the main tool for the leadership, and have continued to play a leading role in the formulation, comprehension and implementation of laws and regulations. Consequently, laws and regulations are not independent and self-existent.

Secondly, as an instrument, law has to record policies. However, as policies themselves may not always be certain, laws and regulations may be left unclear. In order to allow flexibility for, and to avoid debates concerning, the reforms, the law cannot be made too absolute and too detailed. However, the declarative nature of the law has not only left great room for administrative manipulation, but also seriously undermined the legal authority and enforceability of the law.

Thirdly, laws and regulations has been heavily politicised. Many legal provisions are not only social and economic necessity, but also political and ideological targets

²⁶ The PRC authorities hold that law should reflect the views of the ruling class, and therefore has a strong "class nature". In contrast, since the early 1980s, a number of Chinese scholars had advocated that the law was not merely a tool for class struggle as it also performed many social functions. Indeed, some scholars also called for the abandonment of the "class nature view of the law" (see, for example, Wang, Liu and Li, supra note 18). However, this liberal view was severely attacked immediately after June 1989.

²⁷ J. Feinerman, "Economic and Legal Reform in China: 1978-1991", Problems of Communism, Sept-Oct 1991, pp.62-75, at 66.

which may be neither pragmatic nor seriously treated in practice.

Fourthly, as instrumentalities, laws and regulations will be easily put aside when they are found inconvenient for government authorities, or contradicting already changed policies.

Last, but not least, because of various objective difficulties, legal rules are hardly possible to enforce. For example, in the absence of a sound social security system, bankruptcy is not realistic. Accordingly, the EBL is simply an unworkable instrumentality.

In view of the above factors, law does not always mean certainty. Nor can it operate effectively all the time. Indeed, it has become usual practice in post-Mao China that immediately after laws, regulations, legal rules, and concepts are adopted, they tend to be overpraised by the authorities and scholars.²⁸ But such idealisation is soon followed by disappointment, suspicion and controversy. While some people seek to improve existing laws and regulations, others attempt to look for new approaches to replace existing systems. Such controversy not only affects the certainty and authority of laws, but also diverts public attention towards the serious implementation of existing laws.

Reforms in China are still limited. The Chinese leadership has so far been only committed to economic reforms. However, economic and political reforms cannot be separated. Without fundamental political reforms, economic reforms will remain fragile and therefore vulnerable to policy changes.

Considerable difficulties are present in the reforms. Generally speaking, the various difficulties can be classified into two categories. One is objective difficulties which have developed in special and historical circumstances. In our case, these difficulties are represented by the irrational pricing policies and the lack of proper social security system. These problems can be reformed, but the establishment

²⁸ Examples include the legal person concept, management rights, and the contracting system.

of new and proper systems may need a significant period of time. Another category of difficulties is political and ideological obstacles such as the somewhat "bizarre" status of enterprise party secretaries in our study.²⁹ These obstacles are taboo areas for reforms, and great uncertainty may continue to frustrate radical reformers. As a result of these objective and political difficulties, laws and regulations can only perform a limited function. They may support radical reform policies, but in many cases they are only able to stipulate vague and often unworkable legal rules and concepts.

Although economic reforms may create an improved opportunity for the development of a legal framework, and although laws and regulations can be used as instrumentalities to help reforms, it is unrealistic to expect them to fundamentally change the chaotic social, economic, and political systems such as current prevails in China. As suggested by some western scholars, "law is a necessary but not a sufficient condition for meaningful change or development".³⁰ Without fundamental economic and political reforms, the role of the law must not be overestimated. On the other hand, without a proper treatment by laws and regulations of various interests, the reforms are bound to have significant limitations.

IV. Recent Developments and Future Prospects

A. Regulations for the Transformation of the Management Mechanism of State Industrial Enterprises

This research has been carried out mainly on the basis of the material relating to the development of state enterprise

²⁹ Another example is the ideological confusion over the status of workers in state enterprises. In shown in Chapter Seven, for ideological reasons, workers' rights of participation are provided for by law, but remain difficult to enforce as a matter of law.

³⁰ See Feinerman, supra note 27. Also see Clarke, supra note 11.

law up to early 1992. As indicated in the Introduction, in late 1991, a further reform was called for. The main concern is to reduce the number of loss-making enterprises by further increasing enterprise autonomy.³¹ In the wake of a series of speeches made in early 1992 by Deng Xiaoping, China's paramount leader, on the need for bolder economic reforms and more rapid economic development, state enterprise reform has been proceeded with at a faster speed than was expected even in late 1991. This drive to reform seems much stronger than in 1988 when the SEL was adopted. At that time, a much more cautious approach was taken.

The most significant achievement in the on-going campaign has been the promulgation by the State Council on July 23, 1992 of the Regulations for the Transformation of the Management Mechanism of State Industrial Enterprises (hereinafter the "Regulations").³² Comprising a total of fifty-four articles, these Regulations³³ cover, inter alia, the management rights and responsibilities of enterprises, the relationship between enterprises and government departments,

³¹ Until late 1991, of all large and medium-sized state enterprises, about one third were obviously making losses. However, another one third were making "latent losses" (qiankui). "Latent losses" means that from their balance sheets, enterprises seemingly make profits. But if one takes into account factors such as overstock, depreciation, and inflation, these enterprises actually make losses. See a speech made by Zhu Rongji (Vice-Premier) in late 1991 with regard to the drafting of the Implementing Regulations for the SEL, ZGJJTZGG, No.2, 1992, pp.7-9.

³² For the text of these Regulations in Chinese, see RMRB, Jul.25, 1992, pp.1 and 3. For the English text of the Regulations, see BBC SWB, Jul.29, 1992, FE/1445 C1/1-11.

³³ The drafting of these Regulations formally started in December 1991. Eight different drafts were widely discussed before the draft Regulations were eventually approved in principle by the State Council on Jun.30, 1992. For an introduction of the legislative process and relevant contents, see State Economic Reform Commission, Guanyu Quanmin Suoyouzhi Gongye Qiye Zhuanhuan Jingying Jizhi Tiaoli de Shuoming (Explanations Concerning the Regulations for the Transformation of the Management Mechanism of State Industrial Enterprises, hereinafter "Explanations"), GRRB, Jul.23, 1992, p.3.

and the legal liabilities of enterprises and relevant government departments.

1. Main contents of the Regulations

The Regulations consolidate the management rights of state enterprises in fourteen aspects.³⁴ Compared to relevant SEL provisions (as analyzed in Chapter Four), the Regulations not only reiterate the management rights conferred by the SEL,³⁵ but also add a new right -- the right of investment. State enterprises can, in accordance with the law and the provisions of the State Council, invest in other enterprises, or even set up enterprise abroad, by using their retained funds, materials, land use rights, industrial property and non-patent technologies.³⁶ The authorization of this right represents a new development towards a greater degree of enterprise autonomy as enterprises are allowed to make use of state-owned assets and earn profits.

The most notable feature of the Regulations is that the management rights enjoyed by enterprises are stipulated in great detail. Such detailed treatment has aimed at reducing the possibility that government departments abuse their authority and intervene in enterprise management.³⁷ This can be seen in every provision regarding the powers of

³⁴ Arts.8-21. These rights include: decision-making concerning production, pricing for products and labour, the sale of products, purchase of products, import and export, decision-making concerning investment, use of retained funds, disposal of assets, economic association and take-over, labour administration, personnel management, distribution of wages and bonus, installation of internal organisations, refusal of random appropriation.

³⁵ As analyzed in Chapter Four, the SEL authorizes state enterprises with twelve items of rights. Enterprises' right of personnel administration, which was vaguely included in relevant articles of the SEL (Arts.31, 45) is listed separately as a right.

³⁶ Art.13, Regulations. This provision, however, also imposes a number of limitations on the exercise of this right.

³⁷ See "Explanations", supra note 33.

enterprises. For example, the SEL merely contains a brief provision about the right to dispose of assets³⁸ and therefore did not clarify the scope of the disposable assets. The Regulations contain detailed provisions. Thus, in accordance with the needs of production and management, state enterprises may make their own decisions to lease, mortgage, or assign for value their ordinary fixed assets. State enterprises may also lease, or upon the approval from competent government departments, mortgage or assign for value their key equipment, whole sets of equipment or important construction works.³⁹ Thus, the Regulations attempt to not only clarify the coverage of the assets which can be disposed of by enterprises, but also in fact expand this right by allowing enterprises to mortgage fixed assets which they do not own in the first place.

The Regulations also attempt to define both the authority and responsibilities of relevant government departments.⁴⁰ Like the SEL, the Regulations attempt to define the role of government departments in accordance with the principle of separating government administration from enterprise management. On the one hand, government departments continue to bear important responsibility towards the administration of the economy and state enterprises; on the other hand, they are required to exercise macro control and provide services to the autonomous management of state enterprises.

Finally, in order to prevent enterprises from abusing their management rights, the Regulations have moved towards imposing more severe liability on enterprises and their directors. For example, while enterprises which suffer losses because of policy reasons or state plans may be immune from punishment,⁴¹ enterprises which make losses due to poor

³⁸ Art.29, SEL.

³⁹ Art.15, Regulations.

⁴⁰ Arts.40-46.

⁴¹ Art.28, Regulations.

management have to face many liabilities. Such liabilities can be imposed on enterprise directors, other enterprise leaders, and even workers.⁴²

2. Limits of the Regulations

Despite the comprehensive and detailed nature of these provisions, the overall effects of the Regulations should not be overestimated. First, the Regulations do not cover all aspects of the SEL. As their name suggests, the Regulations are only concerned with the "transformation of the management mechanism of state enterprises"; they are not full "Implementing Regulations of the SEL".⁴³ In fact, the Regulations are mainly concerned with the issue of enterprise autonomy and responsibility. Therefore, many complex problems, which, as revealed in this study have complicated the SEL, have not been tackled. For example, the controversial issue of the legal and political status of enterprise directors is not addressed in detail.⁴⁴ Furthermore, the relatively marginal

⁴² Art.29, Regulations. Such liability includes reduction of salary, termination of bonus, and administrative sanctions.

⁴³ The enactment of comprehensive implementing regulations for the SEL seemed to be the original intention of the policy-makers. See "Explanations", supra note 33. Many scholars and government officials with whom I talked in early 1992 did not even agree with the title of the Regulations. They demanded the promulgation of the "Regulations for Implementing the SEL". Also, for an official account of the legislative process concerning the Regulations, see Zhu Rongji, "Guanyu Zhiding Zhuanhuan Qiye Jingying Jizhi Tiaoli de Jige Wenti" (Several Issues Concerning the Enactment of the Regulations), RMRB, Jul.1, 1992, p.2.

⁴⁴ The Regulations mention this issue once. Art.3, which concerns the principles for the transformation of the management mechanism of state enterprises, provides, inter alia, that "giving play to CCP grassroots organisations' function as the political core in enterprises, implementing and perfecting the director responsibility system". This provision, by acknowledging the "political core" position of party committees, has confirmed the development of the enterprise leadership system since June 1989. The draft Regulations, a copy of which I obtained in early 1992, did go further in stipulating the concrete role of the party committees, for example, in enterprise personnel management.

institution of the WSC receives scant attention in the Regulations.⁴⁵ These unresolved problems will continue to affect the operation of state enterprises in the future.

Secondly, the Regulations fail to provide radical measures for resolving many fundamental problems and deep contradictions existing in state enterprise reform.

The Regulations do not make any attempt to confer any property ownership rights to state enterprises. All the property of state enterprises is still exclusively owned by the state, which is represented by governments and their departments.⁴⁶ Accordingly, state enterprises continue to be put under close supervision by government authorities which may abuse their power from time to time.

Furthermore, the Regulations continue to use those terminologies found in the SEL to restrict the "management rights" of enterprises. Many provisions of the Regulations contain qualifying clauses such as "except for where the law provides otherwise or the state has expressly prohibited",⁴⁷ "according to the stipulations of the state",⁴⁸ "except for where the law or the State Council provides otherwise",⁴⁹

However, the promulgated Regulations have dropped such provisions. The underlying reasons for this change is not clear. In my view, it is unlikely that directors in state enterprises can freely use their personnel power (as provided in Art.18, Regulations) without consulting party committees in advance. Therefore, the confusion concerning the enterprise leadership system is likely to continue.

⁴⁵ The Regulations mention twice the role of the WSC. In addition to the ambiguous provision of "relying wholeheartedly on the working class" (Art.3), the Regulations require that enterprises' plans for wage adjustment and bonus distribution be approved by the WSC (Art.24).

⁴⁶ The Regulations provides that the State Council shall represent the state in exercising the ownership rights of the state property (See Art.41).

⁴⁷ Art.10, Regulations.

⁴⁸ Art.11, Regulations.

⁴⁹ Arts.20 and 21, Regulations.

"upon the approval made by relevant government departments",⁵⁰ and "except for where the law and administrative regulations provide otherwise".⁵¹ These restrictions reflect government's cautious approach towards, and will severely undermine, the autonomy of state enterprises.⁵²

In addition, detailed provisions contained in the Regulations fail to establish coherent legal rules for the reasonable treatment of different interests. For example, although the Regulations purport to impose stricter responsibilities for enterprises and especially their directors, this development remains haphazard and incoherent. Moreover, the lack of a proper supervising mechanism means that such liability has to be decided by government departments, therefore enhancing their authority at the cost of enterprise autonomy.

In essence, the improvement made by the Regulations in regard to enterprise autonomy are quantitative, rather than qualitative. Enterprises may rely on the Regulations to obtain more, but not full, autonomy. Equally true, government authorities may be forced by the Regulations to reduce, but not abandon, their intervention and abusive supervision of enterprise management.

Thirdly, the practical effects of these Regulations remain to be seen. This study has shown that many provisions of the SEL have not been effectively implemented. Given the lack of qualitative breakthroughs and the defects in many provisions, the Regulations may suffer from the same fate as the SEL.

For example, as analyzed in Chapter Four, until 1991 the right of state enterprises to refuse "random appropriation"

⁵⁰ Art.12, Regulations.

⁵¹ Art.15, Regulations.

⁵² It has been reported that only upon the special approvement by the State Council has Shoudu Iron and Steel Company (SISC) become the first state enterprise to be granted the full rights of investment, foreign trade, and fund-raising. For the report, see GRRB, Aug.6, 1992, p.1.

(luan tanpai), which had been guaranteed in the SEL and relevant regulations, had met with great difficulty in practice. Nevertheless, it has been reported⁵³ that despite the repeated calls made by the central leadership since late 1991 to stop such illegal practices, random appropriation has occurred frequently and widely. Indeed, so long as various government departments continue to possess unchallengeable authority and play a significant role in the administration of the economy and state enterprises, it is difficult for enterprises to enforce their rights.

In fact, as demonstrated in this study, the guarantee of enterprise autonomy provided by law is rarely relied on by enterprises. State enterprises are neither able nor willing to use the law to fight against government intervention. Although the Regulations reiterate that the legal autonomy of state enterprises shall be protected by law and enterprises can report or appeal to relevant government departments or even bring legal action in order to defend their legal interests and rights,⁵⁴ such guarantees may just prove to be mere empty words.

B. Future reforms and state enterprise laws

Since early 1992, in an attempt to revive the ailing state sector of the economy, the Chinese authorities have been committed to introduce a "socialist market economy" (shehui zhiyi shichang jingji).⁵⁵ State enterprises are to be "pushed"

⁵³ See, for example, a recent report on GRRB, Jul.24, 1992, p.1: "Luan Tanpai Renrang Wuxiu Wuzhi" (Random Appropriation Remains Endless). This report revealed the random appropriation suffered by state enterprises in Henan province where many enterprises were forced to pay various fees and contributions.

⁵⁴ See Art.22, Regulations.

⁵⁵ Although the call for pushing enterprises to the market was made even in 1991, the nature and role of such a market force was not clearly defined. In particular, it was debated within China whether a market economy was socialist or capitalist in nature. In early 1992, Deng Xiaoping initiated

to the market place and forced to compete with enterprises of non-state ownership types. If this move is to succeed, state enterprises will have to experience many significant changes. In particular, their management autonomy must be decisively strengthened.

The most difficult problem, however, remains the contradiction between enterprise autonomy and government supervision. Although various laws and regulations claim to promote enterprise autonomy, therefore inevitably relaxing government domination over enterprise management, government administrative manipulation of state enterprises is still extremely pervasive. For example, despite the growing function of the market force, state economic plans remain very important for state enterprises. Government departments also hold the power to appoint and remove enterprise directors. Moreover, relevant government authorities are entitled to conclude and settle chengbao contracts, approve and veto debtor enterprises' application for bankruptcy and, indeed, to supervise the overall operation of state enterprises. As shown in Chapter Four, the powers and authority of government departments are essentially legal responsibilities borne by these departments in regard to state enterprises.

It would be unrealistic, in any case, to expect government authorities to wash their hands of the operation of state enterprises. However, the most difficult issue is that government departments are not only the de facto owners of state enterprises but social administrators and regulators as well. In the latter capacity, they may legitimately exercise administrative control over the operation of enterprises, but this is complicated by that fact that as representatives of the owner, government departments are entitled to supervise

a new era of economic reforms in which the market economy is described as compatible with either socialist or capitalist economies. Theoretically, this paves the way for the accommodation of a market economy in China. However, it seems that the constitutionality of a market economy is debatable as the 1982 PRC Constitution assumes the dominating role of the state planning and the "supplementary" role of market forces. See Art.15 of the Constitution.

and intervene in the management of state enterprises. To some extent, the dual capacities of government departments can be delineated. For example, the Administrative Bureaux for Industry and Commerce usually exercise their functions as social administrators. But in many other cases, it is impossible to draw a clear distinction as many government departments concurrently exercise the function of both administrators and representatives of the owner. For example, government departments in charge of state enterprises may not only allocate state plans but also appoint enterprise directors. The combination of administrator and owner's status makes the legal regulations concerning state enterprises necessarily subservient to further administrative control. After all, state enterprises are mere managers, not property owners. They may only attain a relative degree of autonomy and independence. Although it is necessary for various state departments to keep an eye on the operation of state enterprises, in many cases such supervision is unnecessarily intrusive in nature. Many government interventions may not only contravene written laws and regulations but even conflict with state policies, as was demonstrated in Chapter Four concerning the autonomy of state enterprises.

The future reform of Chinese state enterprises has four options. The first is that the reform will proceed with the existing approach. This means that state enterprises will only be allowed a "relative degree of autonomy". The second is that radical reform will enable state enterprises to enjoy the same full autonomy as other types of enterprise. The third option is that limited companies will become the dominant organisational form for state enterprises. The fourth option is the widespread privatisation of existing state enterprises.

The first option is the most likely. This is actually the approach that the SEL and the Regulations have taken. Under this approach, the previous system of enterprise administration will be maintained, though minor modifications and reforms will be made. Government departments continue to play an important role in the administration of the economy,

and state enterprises which are only allowed a "relative degree of autonomy".⁵⁶

If this approach is followed, the legal regulation of state enterprises will continue to face the same problems encountered in the past. The policy-orientation of laws and regulations will mean that enterprise autonomy will be subject to administrative and policy restrictions. The legal regulations of state enterprises may be improved to a certain extent, but in essence, such improvement is no more than "treating the head when the head aches, and treating the foot when the foot hurts".⁵⁷ This is because many fundamental problems, such as property ownership rights and the treatment of different interests, will remain unresolved. State enterprises will be unable and unwilling to confront government departments and to protect their own interests by resorting to laws and regulations. As a result, state enterprises will not enjoy the kind of autonomy which would enable them to compete successfully with other enterprises.

Judging from previous experiences, the second option for future enterprise reform appears impossible in the near future. The development of a socialist market economy necessarily requires that state enterprises be given full management autonomy. But the implementation of such full autonomy will not be possible if many essential problems are not first resolved.

In order to realise full enterprise autonomy, it is absolutely critical that the law confers property ownership rights on state enterprises so that they are free to conduct autonomous management. More specifically, first, state

⁵⁶ It seems that considerable confusion still exists as to the nature of the autonomy enjoyed by enterprises. The term of "relative autonomy" was first used in the CCP Decision on Economic Reform, adopted in October 1984. However, since the role of the market was officially acknowledged in late 1991, in particular since the publication of Deng's speeches in early 1992, Chinese officials have tended to talk about "autonomy" of enterprises, instead of "relative autonomy".

⁵⁷ This Chinese saying means "treating symptoms but not the disease".

enterprises which do not possess property ownership are unable to make important decisions concerning their management, or defend themselves from unwelcome government intervention. Secondly, state enterprises are not able to independently bear civil liabilities in regard to the property because they do not have ownership rights in the property of the enterprises. Thirdly, the failure to confer property ownership on state enterprises prevents the development of the concept of the "interests of enterprises" which will enable the law to play an active role in regulating different interests involving state enterprises as legal entities. Finally, and not surprisingly, state enterprises which do not have property ownership rights can hardly become independent and responsible legal persons, able and willing to challenge government authorities.

In essence, without conferring state enterprise with property ownership rights, any proposed legal regulation of state enterprises is bound to have strong policy and administrative features and therefore fail to survive policy changes and administrative manipulations. However, it remains doubtful whether, given its earlier rejection, the Chinese government will be willing to reconsider the idea of conferring property ownership rights on state enterprises.⁵⁸

Moreover, the full implementation of enterprise autonomy would require the abolition of many government departments, in particular, government departments in charge of enterprises. As demonstrated in this study, the existence of these government departments inevitably undermines the autonomy of state enterprises.

The delegation of property ownership rights to state enterprises and the abolition of many government departments, however, cannot automatically resolve many other problems facing an effective and reasonable legal regulation of state

⁵⁸ The authorization of property ownership to state enterprises would have to be sanctioned by the Constitution which, although recognises certain autonomy of state enterprises, prohibits the damages to the state ownership. See Art.16 of the 1982 PRC Constitution.

enterprises. For example, in order to "relieve" government departments of various concerns over the consequences resulting from the full realisation of self-management by enterprises and their managers, the law needs to be modified in order to provide proper treatment of both directors' duties and worker's participation in enterprise management. Furthermore, it is likely that compulsory involvement of party organisations in enterprise management will continue to be a perplexing issue in the context of future reforms. As such, unless a complete and radical overhaul of the existing legal framework is made, effective and proper legal regulation of state enterprises is impossible.

The third option for state enterprise reform still has an uncertain future. The "shareholding system", or gufenzhi, began to be experimented with in pilot areas in the mid-1980s, and has been backed with even greater official enthusiasm since early 1992. By transforming existing state enterprises into Western-style limited companies,⁵⁹ this reform seeks to eliminate many problems existing in state enterprises. In particular, government departments are expected to act in the mere capacity of shareholders, and therefore not to administratively intervene in enterprise management.

The shareholding system may bring some changes to the existing enterprise system.⁶⁰ In particular, the equity participation from investors of different types of ownership poses a threat to, and requires changes in, the existing legal treatment of enterprises. Nevertheless, a number of problems must be considered in assessing the significance of the shareholding system. First, the shareholding system is still at the initial stage of cautious experimentation, the effects

⁵⁹ For a brief introduction to the legislative framework on shareholding companies, see Chapter One above concerning "companies". The Regulations do not apply to limited companies (see "Explanations", supra note 33).

⁶⁰ For an earlier discussion on this potential development, see Howard Chao and Yang Xiaoping, "The Reform of the Chinese System of Enterprise Ownership", Stanford Journal of International Law, Vol.22, 1986, pp.365-97.

of this system cannot be foreseen. In order to ensure the dominance by the state and collective investors in China's socialist economy, it has been made clear by the Chinese authorities that this experimentation must be carried out on the basis of the public ownership. However, given that public enterprises, especially state enterprises, have experienced considerable difficulties in obtaining management autonomy, it is very doubtful whether the establishment of limited companies can fundamentally reform the existing enterprise system.⁶¹ Moreover, the property ownership of such companies is controversial. As examined in Chapter Three, debates are being carried on within China as to whether the investors or the company owns the property. Accordingly, the relationship between government departments and companies is unsettled. A structure which can on the one hand facilitate reasonable government control and on the other hand prevent abusive official intervention has yet to be established. In addition, given the inevitable dominance by public ownership investors in shareholding companies, the appropriate ways to both ensure the "political core" position of party committees and guarantee workers' participation in enterprise management are major issues still to be resolved.⁶²

The fourth option, that is, the privatisation of state enterprises, remains an impossibility in the current political climate. Although a number of small state enterprises have

⁶¹ In response to the recent "share fever" among enterprises and the public, Mr Liu Hongru, vice-minister of the State Economic Reform Commission, is quoted as saying that sellers of shares (that is, enterprises) want to raise funds while buyers want to earn money. Neither of them care about the transformation of the management mechanism of state enterprises. See "China's Thirst for Markets Grows", International Herald Tribune, Aug.10, 1992, p.9.

⁶² In the current experiment of shareholding enterprises, few provisions have been made in these areas. However, as analyzed in Chapters Six and Seven, these two issues are so important that they cannot be ignored. In my view, if in the future shareholding enterprises become the dominant organisational form for state enterprises, the company law will have to address these issues, perhaps by referring to the treatment contained in the SEL.

been sold to non-state entities,⁶³ a large scale privatisation is unlikely to be approved. Such privatisation,⁶⁴ in the official view, would threaten the "Four Cardinal Principles"⁶⁵ which have been respected by the leadership as the basis of the Chinese socialist system.

Whatever road future state enterprise reform is to take, it is certain that successful reform not only requires significant improvements in the overall economic and enterprise administration systems but also demands many fundamental changes in administrative and political infrastructures both within and outside state enterprises. Given that the Chinese authorities have placed emphasis only on economic reforms, although some aspects of the economic and administrative deficiencies accompanying the old system may be reduced or even eliminated, it remains difficult to deal properly with the thorny political and ideological issues which have complicated the reform.

In future reforms, laws and regulations will continue to be employed. However, as long as laws and regulations are used as mere instrumentalities, and if they continue to be policy-oriented, considerable difficulties will be present in bring into full play the functions of legal regulation. The rule of law is a long way for Chinese state enterprises.

⁶³ Recently, for the first time, a large-sized state enterprise in Sichuan Province has been sold to a foreign investment enterprise in China. But in principle, only small-sized state enterprises are allowed to be sold.

⁶⁴ In China, the idea of privatisation of state enterprises was raised in the mid-1980s. However, this idea suffered severe attack after June 1989. Even the current shareholding system, which allows private equity participation in state companies, has to be carried out cautiously in order to avoid the accusation of actual "privatisation".

⁶⁵ These four cardinal principles are: socialist road, Marxism-Leninism and Mao Zedong Thought, the leadership of the CCP, and people's democratic dictatorship.

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GLOSSARY

beikao	备考
bianqu	边区
binlin pochān	濒临破产
biyao de	必要的
bu chengshu	不成熟
caichān	财产
caichānquān	财产权
caichān suoyouquān	财产所有权
chāng	厂
chāngzhāng	厂长
chāngzhāng chēngbāo	厂长承包
chāngzhāng fūzèzhì	厂长负责制
chāoqiānxìng	超前性
chēngbāo	承包
chēngbāofāng	承包方
chēngbāo mùbiāo	承包目标
chēngbāozhì	承包制
chōngshí	充实
chuílián tīngzhèng	垂帘听政
cōngkuān chūlì	从宽处理
dàgāng	大纲
dàibiāo	代表
dàilì	代理
dāng de jīcēng wēiyuánhùi	党的基层委员会
dāng guān gānbù	党管干部
dāngwēi	党委
dāngwēi língdǎo xià de chāngzhāng fūzèzhì	党委领导下的厂长负责制
dānwēi	单位
dēngjiā yǒuchāng	等价有偿
dìfāng guóyíng qīyè	地方国营企业
dìngqī	定期
dōngshìhuì	董事会
duānqī xíngwéi	短期行为
duzī	独资
fā	法
fābāofāng	发包方
fādìng	法定
fādìng dàibiāorén	法定代表人
fǎlǜ	法律

falü xingshi	法律形式
faren	法人
faren daibiao	法人代表
fazhi	法治
fazhi	法制
fen	分
fengxian jijin	风险基金
fenzhi qiye	分支企业
fushuwu	附属物
fuzeren	负责人
gaige	改革
gaohuo	搞活
gaohuo qiye	搞活企业
gangling	纲领
genjudi	根据地
geti qiye	个体企业
gongchang	工厂
gongchangfa	工厂法
gongren	工人
gongsi	公司
gongsi heying qiye	公私合营企业
gongsi tiaoli	公司条例
gongying shiye	国营事业
guanban	官办
guandao	官倒
guandu shangban	官督商办
guanliao ziben	官僚资本
guanshang heban	官商合办
guan, ting, bing, zhuan	关, 停, 并, 转
guanxi	关系
gufen gongsi	股份公司
gufen lianghe gongsi	股份两合公司
gufen youxian gongsi	股份有限公司
gufenzhi	股份制
gufenzhi qiye	股份制企业
gugong	雇工
guoying gongchang	国营工厂
guoying gongye	国营工业
guoying qiye	国营企业
guoying shiye	国营事业
guoyou qiye	国营企业
guoyou zichan guanliju	国有资产管理局
guyuan	雇员
hangye zhuguan bumen	行业主管部门

hehuo
hengxiang lianhe
hexin
hezi gongsi
hezi jingying qiye
hezi youxian gongsi
hezuo jing ying qiye
huoli
huozhe foujue

合伙
横向联合
核心
合资公司
合资经营企业
合资有限公司
合作经营企业
活力
或者否决

jianbing
jiancha bumen
jiandu
jiben falu
jiben luoshi
jiefangqu
jiezhi ziben
jiguan
jijin
jingjian
jingshen wenming
jingying fangshi
jingying fanwei
jingying guanli bushan
jingying guanliquan
jingyingquan
jingying xiangmu
jingyingxing kuishun
jingying zizhuquan
jishu
jiti qiye
jiti suoyouzhi qiye
jueding
juewu

兼并
监察部门
监督
基本法律
基本落实
解放区
节制资本
机关
基金
精简
精神文明
经营方式
经营范围
经营管理不善
经营管理权
经营权
经营项目
经营性亏损
经营自主权
基数
集体企业
集体所有制企业
决定
觉悟

kaibanren
kaiye dengji
keti
kuaikuai
kuisun

开办人
开业登记
客体
块块
亏损

laodong qunzhong
laodong youhua zuhe
li
liandai zeren
liangcan yigai sanjiehe

劳动群众
劳动优化组合
利
连带责任
两参一改三结合

lianghe gongsi	两合公司
liangji faren	两级法人
liangxin bian yixin	两心变一心
lianying	联营
lianying qiye	联营企业
li gai shui	利改税
lingdao	领导
lingdao xiaozu	领导小组
lingdao zuofeng	领导作风
lirun	利润
lirun shangjiao	利润上缴
lirun zhibiao	利润指标
luoshi	落实
mangmu	盲目
mingxian	明显
minsheng zhuyi	民生主义
minzu ziben	民族资本
mozhe shitou guohe	摸着石头过河
nonggongshang bingju	农工商并举
pifu	批复
pingyi	评议
pochan	破产
popo	婆婆
qian	迁
qiankui	潜亏
qingkuang tongbao	情况通报
qingsuan	清算
qishiye danwei	企事业单位
qiye	企业
qiyefa	企业法
qiye jijin	企业基金
qiye jituan	企业集团
qiye minzhu guanli	企业民主管理
qiye zhuguan bumen	企业主管部门
quanli	权利
quanli	权力
quanli jigou	权力机构
quanmin suoyou	全民所有
quanmin suoyouzhi qiye	全民所有制企业
quanyuan chengbao	全员承包
qunti gainian	群体概念

renshi renmian zhengyi
renzhi

人事任免争议
人治

san bubian
sanji suoyou, duiwei jichu

三不变
三级所有，队为
基础

sanrentuan
shangban
shangjiao mubiao renwu
shangren tongli
shao er jing
shedui qiye
shehui zhuyi shichang jingji

三人团
商办
上缴目标任务
商人通例
少而精
社队企业
社会主义市场经济

shencha tongyi
shenghuo zizhiquan
shenyi tongyi
shewai qiye
shizheng gangling
shixing
shoudu gangtie gongsi

审查同意
生活自治权
审议同意
涉外企业
施政纲领
试行
首都钢铁公司

shouyi
shouyiquan
shui
shui hou chengbao
shui hou huandai
shuili fenliu
shuishou
shuishou zhibiao
shuji
siying qiye
siyou xinren
suodeshui
suoyou de

收益
收益权
税
税后承包
税后还贷
税利分流
税收
税收指标
书记
私营企业
四有新人
所得税
所有的

tanpai
ti'an
tiaojieshui
tiaoli
tiaotiao
tiaozheng
tigao
tingqu he shenyi
tongli
tongshou tongzhi
tongzhi

摊派
提案
调节税
条例
条条
调整
提高
听取和审议
通例
统收统支
通知

waishang touzi qiye	外商投资企业
waizi qiye	外资企业
wanshan	完善
weituo	委托
wenming	文明
wuchangxing	无偿性
wuquan	物权
wuxian gongsi	有限公司
xianfengdui	先锋队
xiangdui de	相对的
xiangdui de falü xingzhi	相对的法律性质
xiangdui suoyouquan	相对所有权
xiangzhen qiye	乡镇企业
xiao shehui	小社会
xieye	歇业
xingzheng gongsi	行政公司
xinminzhuzhuyi zhengce	新民主主义政策
xinyu	信誉
xunling	训令
yamen	衙门
yangwu yundong	洋务运动
yansuxing	严肃性
yiping erdiao	一平二调
yizhangzhi	一长制
youguan bumen	有关部门
youxian zeren gongsi	有限责任公司
zhaiquan	债权
zhangdou baolei	战斗堡垒
zhanyouquan	占有权
zhanyouzhe	占有者
zhengdun	整顿
zhengdun gongsi	整顿公司
zhibu weiyuanhui	支部委员会
zhiding	指定
zhigong	职工
zhigong daibiao dahui	职工代表大会
zhigong daibiao dahui lingdao xia de changzhang fuzezhi	职工代表大会领导 下的厂长负责制
zhigong daibiao huiyi	职工代表会议
zhigong xingshi minzhu guanli quanli de jigou	职工行使民主管理 权力的机构
zhili zhengdun	治理整顿

zhiquan
zhishi
zhiyue
zhongnong qingshang
zhongxin
zhuce zijin
zhuchi
zhudong zhuichang
zhuguan bumen
zhuren
zhurenweng de taodu
zibu dizhai
ziben zhuyi weiba
zijin
zixiao
zizhuquan
zonghe zhineng bumen
zongzhibu weiyuanhui
zulin
zulinzhi

职权
指示
制约
重农轻商
中心
注册资金
主持
主动追偿
主管部门
主人
主人翁的态度
资不抵债
资本主义尾巴
资金
自销
自主权
综合职能部门
总支部委员会
租赁
租赁制