ARTICLE

THE CHANGING REGIME FOR REGULATING LOANS OF STATE OWNED BANKS IN CHINA: TOWARDS A SYSTEM OF PRUDENTIAL BANKING

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I. INTRODUCTION

In spite of the deepening problems in the global banking sector caused by the US sub-prime crisis, the four major state owned banks in the People's Republic of China ('the PRC' or 'China') all recorded increases in profits during the first quarter of 2008.[1] For example, during this period, the Industrial and Commercial Bank of China ('ICBC') reported an improvement in net profit of 77% to an amount of ¥ 33.1 billion (USD 4.7 billion). Also the Bank of China ('BOC') increased its net profit by 85% to ¥ 21.7 billion. Similarly, the China Construction Bank ('CCB') made a net profit of ¥ 32.1 billion,[2] while the Agricultural Bank of China ('ABC') increased its profits by 39% to ¥ 54.3 billion (HK$62,21 billion).[3] As a result, the ICBC is devel-

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1. In this article, state owned banks refer to the four major Chinese state owned banks, namely, Agricultural Bank of China, Industrial and Commercial Bank of China, Bank of China and Construction Bank of China. While there are other state owned banks existing in China, they were not the focus of this article and are therefore not considered in great detail in this article.

2. *See* Andrea Li, *Robust Banking Results Belie Global Slowdown*, S. CHINA MORNING POST, Aug. 25, 2008, at (Business) 4; Jamil Anderlini, *Profit Surge at Chinese Banks*, FIN. TIMES (London), Apr. 30, 2008, at 15.

3. Tom Miller, *Agricultural Bank Operating Profit Rises 39% to 56 Billion Yuan*, S. CHINA MORNING POST, July 22, 2008, (Business) at 4.

oping into the one of the most profitable bank in the world.[4] This recent overall growth in the profitability of Chinese state owned banks is not coincidence if we understand the loan regulation reforms undertaken over the past two decades.

In the past, however, Chinese state owned banks had a particularly bad track record in their loan business. Many of the loans they granted were never repaid, resulting in the general problem of non-performing loans and low profitability.[5] However, in the 1990s, Chinese leaders started to reform loan regulations. The state owned banks were converted into commercial banks like those existing in other developed countries.

This article examines the changing loan regulations[6] adopted by China during the conversion of its state owned banks into genuine commercial banks. It considers the implementation problems associated with such loan regulations and the kind of legal reform strategy adopted for such regulatory changes. The article is, therefore, divided into five parts: firstly, it outlines the loan regulations adopted during the 1980s, which laid the foundation for legal reforms to be undertaken over the following two decades; secondly, it analyzes further the loan regulations promulgated during the 1990s; then it considers the adoption of the regulations of November 2001 after the Chinese accession to the World Trade Organization ('the WTO') and goes on to examine areas still in need of reform. Finally, this article evaluates the legal reform strategy for all loan regulations adopted since the 1980s and argues for a concept of 'legal gradualism' which has emerged from these reforms.

II. OVERVIEW OF LOAN REGULATIONS ADOPTED DURING THE 1980s

In the 1980s, China still largely practiced a planned economy in which all banks were state owned and operated their businesses largely in accordance with government plans. Thus, they

4. *See* William Mellor & Eugene Tang, *Chinese Bank Has Market Cap Twice That of JP Morgan; Industrial and Commercial Bank Intends to Become Most Profitable and Influential Bank in the World*, VANCOUVER SUN, (B.C.), June 30 2008, at D8; Natalie Chiu, *ICBC Vows to Be World's No.1 Earner in Five Years; Mainland Banking Giant Steps Up as Credit Crunch Hurts Rivals*, S. CHINA MORNING POST, June 6, 2008, (Business) at 1.

5. *See generally* JIANBO LOU, CHINA'S TROUBLED BANK LOANS: WORKOUT AND PREVENTION (2001) (analysis of the problem of non-performing loans).

6. The term 'loan regulations' is understood broadly in this article, as referring to the whole body of national legislation promulgated by the National People's Congress and its Standing Committee, the administrative regulations and promulgations made by the State Council, the People's Bank of China, and other state organs (such as the China Banking Regulatory Commission) that were directly or indirectly relevant in bringing about the reform of the loan system in China.

were not independent business entities as in market economies. Under this system, the State Council was the highest organ of state determining the money supply and amount of loans granted. The banks were therefore responsible for implementing state monetary policy, being required to grant loans in accordance with state plans and directives from state organs.[7]

During this decade, China adopted three important loan regulations: the Economic Contract Law (1981),[8] Regulations on Loan Contracts (1985)[9] and General Principles of Civil Law (1986).[10] These three loan regulations were of general applicability to all Chinese banks. The Economic Contract Law was the first piece of national legislation that made it mandatory for Chinese banks granting loans to enter into loan contracts. Under the law, the banks had to specify the amount, purpose, term, interest, settlement method and consequences for any breaches of the loan contract.[11]

However, as such loan contracts were entered into within the context of a planned economy (on the basis of state plans and directives from state officials and local governments) the Chinese banks had little freedom of contract as enjoyed by commercial banks in market economies. For example, the banks could be compelled by the government to enter into loan contracts with state owned enterprises having little or no repayment capabilities.[12]

Promulgated in 1985 and subsequent to the Economic Contract Law (1981), China adopted the Regulations on Loan Contracts, which represented the first national administrative regulation governing loan contracts. These Regulations contained various mandatory provisions. It included not only loan

7. *See generally* YI GANG, MONEY, BANKING AND FINANCIAL MARKETS IN CHINA 22 (1994) (discussion of role of the Chinese banks in the 1980s).

8. For the full text of the Economic Contract Law, *see* QUANGUANGUO RENMIN DAIBIAO DAHUI CHANGWU WEIYUANHUI FAZHI GONGZUO WEIYUANHUI [*Legislative Affairs Committee Of National People's Congress Standing Committee*], 5 ZHONGHUA RENMIN GONGHEGUO FA DIAN [CODE OF THE PEOPLE'S REPUBLIC OF CHINA LAW SERIES] 11 (2001). The ECL ceased to take effect following the adoption of the Contract Law in 1999. Contract Law ceased to take effect following the adoption of the Contract Law in 1999.

9. For the full text of the Regulations on Loan Contracts (1985), *see* Wei Shenghong, Shang Zhengming & Ma Delun, COMPLETE BOOK OF BANKING LAW 923 (1995).

10. For the full text of the Regulations on Loan Contracts, *see* WEI SHENGHONG, SHANG ZHENGMING & MA DELUN (ed.), YINHANGFA QUANSHU [COMPLETE BOOK OF BANKING LAW] 923 (1995).

11. Economic Contract Law (1981), Art.24.

12. Some Chinese academics took the view that contracts entered into at that time were merely in form rather than substance. *See* KONG LIULIU, SHANGYE YINHANG JIEDAI HETONG XINGWEI LILUN [THEORY ON LOAN CONTRACT BEHAVIOUR OF COMMERCIAL BANKS] 114 (2001).

types, purposes, amounts and interest, but also the source of funds for repayment, repayment methods, guarantee provisions, and legal responsibilities for breaches of contracts.[13] Banks and their borrowers were also entitled to vary or discharge the loan contracts under certain circumstances, such as the revision or cancellation by the relevant government authorities of state plans and budgets which formed the basis of the contracts. Similar variation or cancellation of the loan contracts could also take place if relevant construction projects were either cancelled, stopped or delayed by the approving government authorities; or if the borrowers were given approval by the same relevant authorities to close down, stop production, merge, split or convert, rendering it impossible for the borrowers to perform the loan contracts. In addition, the contracts could be varied or cancelled as a result of *force majeure* or accidents, making the further performance of loan contracts impossible; or if continued performance of the loan contracts would cause loss and wastage due to improper policies.[14]

These provisions demonstrate, therefore, the close relationship in the 1980s between Chinese state policies and bank loans. Consequently, both state owned banks and their borrowers had no control over the 'fate' of the loan contracts that they signed. Rather, they had to manage them according to the implementation of the already mentioned plans and directives from government departments. Clearly, Chinese banks enjoyed little autonomy in this era.

Nevertheless, as pointed out by Xiao, the Regulations on Loan Contracts (1985) were not as effective as envisaged. For example, there were some banks who did not always undertake vigorous investigations and approvals of their borrowers, while others failed to carry out thorough investigation and valuation work or to request from borrowers relevant materials for investigation and valuation. In other cases, the bank staff only dealt superficially with materials submitted by the borrowers, paying little attention to issues concerning operations, business prospects and the repayment abilities of their borrowers before granting the loans. As a result, many bank loans were never repaid. In yet more cases, the loan contracts did not contain the mandatory terms prescribed by the Regulations on loan term, interest and purpose. Other loan contracts omitted clauses stipulating the legal consequences for breaching the loan contracts, making it difficult for the banks to enforce them after default of their borrowers. Overall supervision and monitoring of the bor-

13. Regulations on Loan Contracts (1985), Art.6.
14. *Id.* Art.11.

rowers were often inadequate, with some borrowers changing the loan purposes without informing their banks, while others unlawfully used the loans to speculate in stocks and futures.[15] Such poor implementation led some Chinese commentators to claim that the Regulations existed only on paper, and not in reality.[16]

In 1986, China adopted the General Principles of Civil Law, which was the first national legislation in the country requiring borrowers to provide loan securities to banks. With this piece of legislation, the banks could better insure themselves and receive compensation in the event of the borrowers' default by the creation of loan securities, which included guarantees, pledges, cash deposits and liens.[17] However, as most of the properties were owned by the state, property rights were not clearly defined by law, so it remained doubtful in many cases whether the loan securities were either lawful, capable of constituting loan securities at law or enforceable by the banks in the event of borrowers' default.[18]

In addition, individual state owned banks also promulgated their own loan regulations during the 1980s. These included the Provisional Measures on Management of Secured Loans promulgated by the Industrial and Commercial Bank of China in 1987;[19] Measures on Loans for Fundamental Construction adopted by the People's Construction Bank of China in 1989;[20] and Provisional Measures on Regulation of Loans announced by the Agricultural Bank of China in 1990.[21] All of these reflected a 'sector-specific' nature so that under such regulations, different Chinese state owned banks issued different regulations for their own specific businesses and customers. For example, the Agricultural Bank of China obviously targeted loans to the agricultural sector, while the People's Construction Bank of China was engaged mainly in financing business for 'fundamental' national construction projects. Unlike national legislation, therefore, these administrative regulations had only limited application, restricted to loan business operations of individual banks.

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15. XIAO YUPIN (ed.), JIEKUAN HETONG [Loan Contracts] 34-35 (1999).

16. Chen Dazhen, Li Shuxiong and Huang Zhihe, *Lun Xindai Zijinfa Lüvfa Guanli* [*On the Legal Management of Loan and Credit Capital*"], 1 DIAOYAN YU XINXI [RESEARCH AND INFORMATION] 24 (1995).

17. Principles of Civil Law (1986), Art.89.

18. Chen et al., *supra* note 16.

19. For the full text of the Provisional Measures on Management of Secured Loans, *see* WANG GUOXIANG & FAN ZHIGANG, YINHANGFA QUANSHU [COMPLETE BOOK OF BANKING LAW] 252 (1995).

20. For the full text of the Measures on Loans for Fundamental Construction (1989), *see id.* at 281.

21. For the full text of Provisional Measures on Regulation of Loans (1990), *see id.* at 263.

In retrospect, however, these 'sector-specific' loan regulations can be seen as laying the foundation for the subsequent adoption during the 1990s of such national legislation as the Security Law (1995). For example, the Industrial and Commercial Bank of China promulgated the Provisional Measures on Management of Secured Loans (1987), which set out the types of assets that were eligible as loan securities, namely, valuable fixed assets, securities, and movable properties that could be subject to seizure, and other assets or physical resources that were transferable or capable of circulation.[22] The secured loan contracts also had to contain certain mandatory terms, such as the amount, purpose, term, interest rate, and repayment methods of the principal and interest of the loans; the nature, size, quantity, present value, validity usage period, and quality condition of the securities; percentage of mortgage; custody method and custody responsibilities of securities; and legal responsibilities for breaches of contracts.[23] These provisions were very similar to those of the Security Law (1995) thereby demonstrating a 'gradualist' legal reform strategy which I will return to later.

In the same manner, the aforementioned Provisional Measures on the Regulation of Loan (1990), adopted by the Agricultural Bank of China, introduced many innovations in the same manner in order to reduce the business risks of bank loans. These were also incorporated into the loan regulations such as the Commercial Banking Law (1995) and the General Rules on Loans (1996). For example, the Measures laid down a monitoring policy for the loans.[24] A loan management responsibility system was also imposed.[25] Moreover, the Measures included a system of linking performance results with reward and punishment.[26] To a large extent, therefore, these Measures can be regarded as a 'forerunner' of the loan regulations subsequent adopted by China, thereby reflecting again a 'gradualist' legal reform strategy.

Although state owned banks were legally defined as 'independently-audited autonomous entities' under the Provisional Regulations for Management of Banks adopted in 1986, the loan regulations adopted during the 1980s did not in reality give state owned banks the kind of business autonomy that they needed to run their loan business. In this era, there was no clear separation of policy loans and commercial loans. Consequently, the banks had to perform dual roles in which they were making policy loans

22. Provisional Measures on Management of Secured Loans (1987), Art.6.
23. *Id.* Art.10.
24. Provisional Measures on Regulation of Loans (1990), Art.23.
25. *Id.* Ch. 7.
26. *Id.* Art.26.

to borrowers in accordance with state plans or as directed by state officials and local governments. As a result, the loan contracts were not voluntarily made by the parties under a freedom of contract commonly understood in market economies.

Since state owned banks operated their loan business within the limits of state plans, they were entirely subject to revision or cancellation in accordance with state policies. Again, this was, of course, in direct contrast with market economies where customers came under freedom of contract with the state having no *locus standi* to intervene. Furthermore, the loan regulations operated in the context of a 'credit plan' system under which a quota was set by the central government for the total amount of loans that Chinese banks could make.[27] As a result, the banks had no incentive to develop or to maximize profits and grow their loan business. Indeed, they did not heed the risks of granting loans to those borrowers who had little or no capability of repayment.

Finally, even though the regulations provided for loan securities during the 1980s, in reality, they were irrelevant to the bank loans as clearly they were mostly made to state owned enterprises, not backed up by loan securities, never repaid, and then became bad debts. For example, nearly 15% of the loans were not repaid during the second half of the 1980s,[28] but by 1989, based on these estimates, the total amount of loans made by Chinese banks was ¥ 1240.9 billion of which those not repaid amounted to ¥ 180 billion.[29] Therefore, the loan regulations adopted in the 1980s were not effective and in need of reform.

2. *Reform of Loan Regulations in China During the 1990s*

A. Background for Regulatory Reform – Four Important Policy Changes

In the early 1990s, China took more radical steps to reform its loan regulations as a result of four important policy changes. First, the country separated policy and commercial loans, thereby freeing its four major state owned banks to focus on commercial loans and to grant bank loans according to market mechanisms. In fact, the percentage of policy loans in Chinese banks varied from 20% for the Industrial and Commercial Bank of China, to 30% for the Agricultural Bank of China, to 15% for the Bank of

27. *See* Yi, *supra* note 7, at 65-66, for an analysis of the formulation of 'credit plans.'

28. *See* Zhu Delin, *Lun Woguo Huobi Gongying De Qiangzhi Jizhi* [*On the Forced Money Supply Mechanism in China*], Fin. Research, Sept. 1989, at 8-12.

29. *See* Yi, *supra* note 7, at 69.

China and to 45% for the People's Construction Bank of China.[30]

In 1993, China promulgated the 'Decisions on Financial System Reforms',[31] which confirmed the separation of policy and commercial loans.[32] In that year, three policy banks, namely, the State Development Bank of China, the Import-Export Bank of China and the Agricultural Development Bank of China were established by the State Council and started to operate.

This reform, separating policy and commercial loans, forced state owned banks to assume more responsibility for their loan decisions. Therefore, state owned banks could no longer evade their legal responsibility for bad loan decisions by alleging that they were policy loans and not commercial loans. This considerably strengthened their accountability.

Another important policy change was the abolition of the 'credit plan' system under which quotas were set by central government for the amount of loans that different state owned banks could make. This system was not conducive to the liquidity and profitability of the banks, as the latter were not able to determine independently the use of their capital.

However, the third important policy change was an increase in the autonomy of state owned banks to determine the loan interest rates, which enabled them to act more like commercial banks in market economies. Commercial loans would be granted at interest rates determined by market conditions, thereby allowing banks to make the best use of their funds.

Finally, the fourth policy change made by the Chinese leaders was an acceleration of the reform of the loan regulations, which was reinforced by the imminent accession of China to the WTO and the subsequent opening of the Chinese banking sector to foreign banks.

OVERVIEW OF THE 1990S REGULATIONS

During the 1990s, therefore, we have seen China adopted important loan regulations by way of national legislation, such as the Commercial Banking Law (1995),[33] the Security Law (1995)[34] and General Principles on Loans (1996).[35] The country

30. Xu Xiaoping, *Choosing a Proper Banking Model during the Economic Transition*, [ECON. RES.], Jan. 1994, at 17-23.

31. For the full text of the DFSR, *see* ZHONGGUO FA LÜ NIANJIAN [CHINA LAW YEARBOOK] 640 (1994).

32. *Id.* at para. 2.

33. For the full text of the CBL, *see* ZHONGGUO FA LÜ NIANJIAN [CHINA LAW YEARBOOK] 238 (1996). The CBL was revised in 2003

34. Security Law (promulgated by the Standing Comm. 8th Nat'l People's Cong., June 20, 1995, effective Oct. 1, 1995) 1995 QUANGUANGUO RENMIN DAIBIAO

also promulgated important administrative regulations like the Notice on Guiding Principles of Strengthening the Internal Control Systems of Financial Institutions (1997)[36] and the Guiding Principles on Loan Risk Classification (Provisional) (1998).[37] In addition, different Chinese banks also promulgated their own loan regulations which included the Loan Security Management Measures (1996) adopted by the People's Construction Bank of China, the Loan Security Provisional Measures (1997) promulgated by the Industrial and Commercial Bank of China, and the Loan Security Management Measures (1997) adopted by the Agricultural Bank of China. These all established a new legal framework for Chinese banks to operate in ways similar to commercial banks in market economies.

To begin with, the Commercial Banking Law (1995) increased the autonomy of state owned banks to make loans by giving them more freedom over interest rates. These loan interest rates were based on upper and lower limits set by the People's Bank of China.[38] Under the Law, the banks also had to comply with various asset liability ratios in granting loans stipulated by the Commercial Banking Law. These included stipulations that the capital adequacy ratio be not less than 8%, the ratio of balance of loans to balance of deposits be not less than 75%, the ratio of balance of liquid assets to balance of liquid liabilities be not less than 25%, and the ratio of balance of loans granted to the same borrower to balance of capital of state owned banks not exceed 10%.[39]

This asset liability ratio system constituted a risk management system imposed by the People's Bank of China on state owned banks in order to replace the 'credit plan' system used in the 1980s. The new system enabled the banks to run their loan business in a more flexible manner in that they were prohibited from making loans to their customers unless they possessed the requisite amounts of assets. The rationale for such a new system

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DAHUI CHANGWU WEIYUANHUI FAZHI GONGZUO WEIYUANHUI [Legislative Affairs Committee Of National People's Congress Standing Committee], ZHONGHUA RENMIN GONGHEGUO FA DIAN [Code Of The People's Republic Of China Law Series] 103.

35. General Rules on Loans (promulgated by the People's Bank of China, 1996), BAKER & MCKENZIE, CHINA BANKING AND FINANCE: ESSENTIAL LEGISLATION 138 (Asia Information Associates 2000).

36. *Notice on Guiding Principles of Strengthening the Internal Control Systems of Financial Institutions* 6 ZHONGGUO REN MIN YIN HANG [GAZETTE OF THE PEOPLE'S BANK OF CHINA] 3 (1997).

37. Guiding Principles on Loan Risk Classification (Provisional) 6 ZHONGGUO REN MIN YIN HANG [GAZETTE OF THE PEOPLE'S BANK OF CHINA] 16 (1998).

38. Commercial Banking Law (1995), Art.30.

39. *Id.* Art.39.

was that if the volume of loans made by the banks exceeded their total assets, they could be exposed to substantial business risks.

The Commercial Banking Law also laid down other procedures for limiting the business risk of state owned banks in their loan operations. For example, they were required to verify borrowers' credit, loan purpose, repayment ability and methods of borrowers in a diligent manner.[40] This verification process reflected the 'security principle' emphasized in the Law.[41] As already discussed, in the past, many state owned banks granted loans to borrowers without verifying their 'creditworthiness' so that many ailing state owned enterprises could not repay their loans which then became non-performing.

The General Rules on Loans adopted in 1996 were obviously developed on the basis of the aforementioned Regulations on Loan Contracts. These 1996 Rules tightened the control of extension of repayment terms.[42] Previously, many borrowers extended their repayment terms indefinitely whenever they were unable to repay, thereby further aggravating the problem of 'non-performing loans'. Chinese policymakers therefore attempted to rectify such 'malpractice' by limiting the maximum period that banks could extend their repayment period.

Like the Commercial Banking Law, the General Rules also specified detailed criteria for banks to screen 'eligible' borrowers.[43] While banks were given more autonomy in their loan business, they could also be tempted to ignore risks and grant loans to more borrowers. These provisions therefore imposed more obligations on the banks to ascertain their borrowers' eligibility.

In granting loans, state owned banks also had to comply with the asset-liability ratios stipulated in the Commercial Banking Law,[44] and refrain from granting 'fiduciary loans' to 'connected persons'. They were also prohibited from granting guaranteed or secured loans to 'connected persons' on terms and conditions more favorable than those loans granted to other borrowers.[45] In fact, of the practices of asset-ratio liability ratios, no granting of 'fiduciary loans', and no 'guaranteed loans' or 'secured loans' to 'connected persons' on favorable terms, were all modern banking techniques introduced to reduce business risks.

The banks were also required to assess their borrowers' credit ratings based on their management quality, economic strength, capital structure, compliance track record, operational

40. *Id.* Art.35.
41. *Id.* Art.4.
42. General Rules on Loans (1996), Art.12.
43. *Id.* Art.17.
44. Commercial Banking Law, Art.39.
45. General Rules on Loans, Art.24.

efficiency and development prospects.[46] They had to undertake investigations of the legality, security and profitability of the loans; verify the pledged or mortgaged properties and guarantors; and assess the risks of such loans.[47] For such purposes, Chinese banks established loan management systems consisting of 'separation of approval and verification' and 'approval and verification at different levels'.[48] Both these systems were again risk management techniques introduced by the General Rules and were adopted by commercial banks in market economies to reduce the corruption of bank staff in approving illegal loans to borrowers.

As the 'non-performing loans' were a serious problem for state owned banks, the General Rules (1996) required banks to establish a quality monitoring system to classify, register, examine and call in 'non-performing loans'.[49]

Furthermore, the General Rules established a system of 'presidential responsibility'. Under this system, bank presidents at different levels were to be wholly responsible for granting and collecting loans within their jurisdictional limits. Moreover, banks had to 'station' their credit officers in the offices of their 'major' borrowers.[50] They were required to establish a system of 'audit upon staff departure', under which banks, at the time of departure of credit officers, would audit the loans approved by them during their term of office.[51] These innovations improved the personal accountability of state owned bank officers and could be regarded as monitoring mechanisms 'with Chinese characteristics'.

The Security Law (1995) represented another important loan regulation adopted during the 1990s. It was the first national legislation in China to create a legal framework for loan securities. If we compare the contents of the Security Law with those of the Economic Contract Law, the General Principles of Civil Law and various 'bank-specific' 1980 loan regulations of individual Chinese banks that contained provisions for the creation of loan securities, we can see that the Law was developed on the basis of these 1980 loan regulations. This is yet another example of the 'gradualist' legal reform strategy considered later.

The Security Law provided for the creation of five modes of loan securities; namely, guarantees, mortgages, pledges, liens and

46. *Id.* Art.26.
47. *Id.* Art.27.
48. *Id.* Art.28.
49. *Id.* Art.33.
50. *Id.* Art.43.
51. *Id.* Art.44.

deposits.[52] It tightened control of institutions eligible to act as guarantors. For example, state authorities were generally not permitted to act as guarantors,[53] nor were institutions and organizations for the public good such as schools, kindergarten and hospitals.[54] The Security Law also restricted branch organizations and functional divisions of 'enterprise legal persons' unless they were authorized in writing, and could provide guarantees within their permitted scope of authority.[55] Previously, the banks found it difficult to enforce the guarantees because some guarantors were subsequently discovered to be state authorities or other public bodies that lacked the requisite legal capacities to give valid guarantees. As their properties belonged to the state, the banks could not realize the loan securities created over them.

In addition, borrowers could not mortgage the same properties to other banks unless the value of the mortgaged properties exceeded the value of the loan indebtedness.[56] This provision was designed to prevent borrowers from 'double-mortgaging' their properties to different banks, a practice which, common in the past, had caused many problems for state owned banks trying to enforce their mortgages. In the past, some borrowers mortgaged the same properties to more than one bank. Thus, when they defaulted in repayment, the banks were unable to enforce the mortgages to recover their loan indebtedness as the same properties were also mortgaged to other banks.

Furthermore, there were certain categories of properties which borrowers could never mortgage to state owned banks. These included land ownership, land use rights to 'collectively owned land', educational facilities, medical and public health facilities and other public welfare facilities of public institutions such as schools, kindergartens, and hospitals; properties of which the ownership or land use rights were unclear or in dispute; and properties subject to court judgment execution, seizure or supervision.[57] In the past, state properties had been used as mortgage properties so that when the borrowers defaulted the mortgages could not be enforced. These provisions were an attempt to prevent borrowers from using those properties that could not be validly mortgaged to the banks.

In addition, state owned banks had to register the mortgages with the relevant state authorities to ensure their validity.[58] The

52. Security Law (1995), Art.2.
53. *Id.* Art.8.
54. *Id.* Art.9.
55. *Id.* Art.10.
56. *Id.* Art.35.
57. *Id.* Art.37.
58. *Id.* Art.41.

registration authorities on mortgages depended on the type of mortgage property.[59] If they were not properly registered, they would become void against third parties.[60] This system therefore also attempted to solve the problem already indicated of borrowers obtaining additional amounts of loans unlawfully by mortgaging the same property to two banks consecutively.

Following adoption of the Security Law (1995), individual state owned banks also promulgated their own regulations for creation of loan securities, which set out detailed operational guidelines for individual banks in creating loan securities. These include the Loan Security Management Measures (1996) adopted by the People's Construction Bank of China, the Loan Security Provisional Measures (1997) promulgated by the Industrial and Commercial Bank of China, and the Loan Security Management Measures (1997) adopted by the Agricultural Bank of China. These regulations focused on three common themes. First, they emphasized the importance of secured loans. Next, they required the banks to exercise due diligence in determining the eligibility of the guarantors and suitability of loan securities. Finally, they laid down detailed procedures that Chinese banks should follow in the creation, monitoring, and realization of loan securities.

In anticipation of its imminent WTO accession, China also introduced various measures to strengthen loan regulation in the late 1990s, such as the Notice on Guiding Principles of Strengthening the Internal Control Systems of Financial Institutions in 1997. Under the Notice, Chinese banks were required to establish effective internal control systems that could prevent loan risks and improve loan quality.[61] As we will see below, this strengthening of the bank internal control systems became a key area of Chinese concern after the WTO accession. To that end, China promulgated the Guide on Internal Control of Commercial Banks in 2002 and the Guide on Internal Control of Commercial Banks in 2007, which, as we consider below, was clearly adopted on basis of this 1997 Notice.

In addition, China introduced the Guiding Principles on Loan Risk Classification (Provisional) in 1998 to revamp the old classification system inherited from the days of a planned economy, whereby banks had to classify their loans into four categories: 'normal', 'overdue', 'stagnant', and 'bad debts'. Under the new Guiding Principles, five new categories of classification were

59. *Id.* Art.42.

60. *Id.* Art.43.

61. Notice on Guiding Principles of Strengthening the Internal Control Systems of Financial Institutions (1997), at para.11.

required; namely, 'normal', 'concerned', 'inferior', 'doubtful', and 'loss'.[62] These new classifications helped the banks to establish a modern risk management system. As we will see below, China continued to emphasize this 'five-category' system after WTO accession by promulgating the Guiding Principles on Loan Risk Classification (2002) which, as we analyze below, was obviously based on these 1998 Guiding Principles.

C. Policy Goals of the 1990 Loan Regulations

In retrospect, the 1990 loan regulations can be seen to have achieved eight policy goals. First, they enabled borrowers to apply for loans from different state owned banks. In doing so, these regulations radically transformed the old regime under which different state owned banks targeted different sectors and types of loans in the country. Such an 'artificial' division of loan business was clearly a product of a planned economy and not compatible with the business needs of a market economy. Consequently, the abolition of 'designating' different state owned banks to cater for the needs of specific sectors and types of loans allowed the banks to diversify their loan business into new sectors and borrowers and so enabled them to operate their loan business and select their borrowers on market principles. Likewise, the loan regulations gave borrowers the freedom of choice to borrow from more than one state owned bank or to choose their preferred one, which implied more freedom to accepting or reject loans offered by different state owned banks.

Second, the 1990 loan regulations put pressure on borrowers to 'compete' for loans from state owned banks. Under a planned economy, the banks had been directed to grant loans only to designated borrowers so that many of them in particular state owned enterprises, did not need to worry about their loans. However, with the passage of the 1990 loan regulations borrowers could no longer rely on state plans nor expect state owned banks to supply loans 'automatically'. Rather, the regulations emphasized that banks could not be compelled to grant loans to borrowers, who, as a consequence, now had to compete for loans by demonstrating that they were suitably 'qualified' borrowers.

Third, the 1990 loan regulations emphasized the principle of 'profitability', which is compatible with market economics in loan business.[63] With the need now to maximize profits, banks would only grant loans to those borrowers who could bring the highest returns and demonstrate their repayment abilities.

62. Guiding Principles on Loan Risk Classification (Provisional) (1998), Art.3.
63. *Id.* Art.4.

Furthermore, their regulations strived to improve the quality of bank customers by imposing more stringent requirements on the eligibility of borrowers. For example, borrowers were required to possess requisite asset-to-debt ratios before they were eligible to apply for loans from state owned banks.[64] Bank borrowers were therefore forced to change their attitude towards running their businesses.[65] They had to operate their business efficiently before they could become eligible for loans and if they failed to meet the legal requirements, they could no longer expect loans 'automatically', as in the past planned economy of the past. In addition, the new regulations imposed pressure on borrowers to improve the transparency of their financial circumstances which created incentives to exercise more discipline over financial affairs and business operations. In the process the quality of bank customers would be enhanced.

What is more, a new set of national standards and practices was established for state owned banks in the operation of their loan business compared with the regulations of the 1980s when banks had their own individual loan regulatory regimes. The former fragmentation was no longer compatible with the changing economic development of the country in the 1990s.[66]

The 1990 loan regulations also 'modernized' loan operations in China. For example, not only was there greater transparency of the loan process, but the regulations also clarified the types of loans that borrowers could procure from state owned banks.[67] They also imposed more restrictions on loans purposes[68] and borrowers were prohibited from evading their loan responsibility,[69] thereby clarifying the rights and obligations of banks and their borrowers. In particular, the regulations strengthened the accountability of bank officers for the loans they granted and laid down clear guidelines for bank personnel to follow in conducting this business.[70]

Overall, the 1990 loan regulations laid down a modern framework for loan management and contributed to the long-term improvement in loan quality. This is confirmed by research conducted by the PBOC in 2003 on the impact of the implementation of the General Rules on Loans. It revealed that the qual-

64. General Rules on Loans (1996), Arts. 17(5) and 17(6).

65. Du Deqing, *What the General Rules on Loans Bring to Enterprises*, FIN. TIMES (London), Aug. 4 1996, at 4.

66. Donald Clarke, *The Execution of Civil Judgments in China*, *in* CHINA'S LEGAL REFORMS 66, (Stanley Lubmam ed., 1996).

67. General Rules on Loans (1996), Ch. 2.

68. *Id.* Art.20

69. *Id.* Ch. 9

70. *Id.* Ch. 6

ity of loans granted after the implementation of the 1996 Rules continued to improve over the years while the amount of newly-created 'non-performing' loans consistently declined.[71]

Finally, as evident from the previous section, the Securities Law (1995) and other loan regulations adopted by individual Chinese banks enabled state owned banks to take various kinds of loan securities from borrowers. These regulations also established a comprehensive legal framework for dealing with the many operational issues involved, e.g., their valuation, registration and realization. In doing so, this gave state owned banks better legal protection and more effective legal remedies in the event of their borrowers' defaults in loan repayments like their commercial bank counterparts in other market economies.

D. Implementation of 1990 Loan Regulations

While the 1990 loan regulations were largely successful in accomplishing their desired policy goals, in reality, however, many practical issues hindered their effective implementation. These included the borrowers' illegal use of bank loans and the banks' failures to comply with prescribed procedures for approval and verification, or supervision and monitoring. Implementation failures were further compounded due to inefficiencies in enforcing loan contracts through court proceedings and executing court judgments against the borrowers in default.

In addition, success was impeded by a range of other problems: the prevalence of 'illegal' or 'unenforceable' mortgages, the banks' acceptance of invalid loan securities, the 'non-existence' of registration departments for loan securities, the overcharging of registration and valuation fees, the short limitation periods for enforcing loan securities, the banks' delay in instituting legal proceedings against guarantors, the difficulties in realizing the loan securities and the corruption of bank staff.

To amplify, while non-financial institutions in China could not lawfully engage in loan business, many borrowers used the money borrowed from their banks to make loans to third parties, thereby earning high interest rates.[72] In other cases, borrowers used such monies for repayment of old debts, rather than for

71. People's Bank of China, Xing Anmeng Centre Branch Research Group, *Survey on Changes in Loan Quality after Implementation of the General Rules on Loans*, 1 Jin Rong Yan Jiu [Fin. Research] 38 (2004).

72. Liu Jun, Fan Aihua, Wu Bin, Liang Wenyong & He Yiqun, Banking Law and Practice 89 (1999).

their business operations. As a result, the banks' financial capability deteriorated and debts exceeded assets.[73]

Secondly, many state owned banks did not strictly follow the approval and verification process prescribed in the loan regulations. Nor did they, in practice, strictly approve and verify the legal capacities of the borrowers and guarantors. In some cases, borrowers even submitted forged documents to their banks to 'verify' their creditworthiness and asset worth. Many reports on the 'capital worthiness' of borrowers were faked, thus leading to an inaccurate picture of their financial capability.[74]

Implementation problems also arose from the ineffective enforcement of the loan contracts through court proceedings and execution of the court judgments. Many state owned banks failed to recover their loan indebtedness even when they won the cases and obtained judgments against their borrowers. For example, it was reported that one bank instituted court proceedings against forty-six borrowers in a period leading up to the end of June, 2001. Although the bank won all the cases, ten borrowers subsequently absconded, two became bankrupt, and execution against another twenty-six of the defendant borrowers failed for various reasons. Eventually, the bank was only successful in executing judgments against eight borrowers. Banks also faced the high costs of court litigation. Apart from the expensive court fees, the banks had to use a portion of their loans recovered for settling various miscellaneous fees. In the end, the money available for repaying the bank loans was substantially reduced.[75] These difficulties confirm the validity of Clarke's observations on China's lack of sufficient institutional support in executing court judgments.[76]

The 1990s regulations were also affected by the prevalence of 'illegal' or 'unenforceable' mortgages. That is to say, some borrowers created mortgages over properties that did not exist or could not be disposed of. When the borrowers failed to repay the loan indebtedness, state owned banks found it difficult or impossible to realize the mortgaged properties for repayment. Another form of fraud was collusion between borrowers and guarantors. Advanced loans to borrowers were granted on the

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73. *See also* Jiao Fengchuan & Li Aijun, *Thinking on Issues Relating to General Rules on Loans*] ZHONGGUO CAI ZHENG [CHINA FIN.], Sept. 2000, at 62 (discussing the phenomenon of borrowing loans to repay existing debts).

74. Liu et al., *supra* note 72.

75. Wang Yufeng, Wang Zhili & Zhao Longwu, *Problems faced by State Owned Banks in Reducing Their 'Non-performing' Loans and Suggested Solutions*, 3 FIN. REFERENCE 88, 89 (2002).

76. Donald Clarke, *Dispute Resolution in China*, 5 ZHONGGUO FA YAN JIU XUE KAN [JOURNAL OF CHINESE LAW] 245, 262 (1992).

strength of guarantees given by other guarantors but later it turned out that the borrower and guarantor companies were owned or controlled by the same enterprise or individual. As a result, both the borrowers and guarantors absconded without repayment.[77]

For instance, a survey conducted on twelve banks in Gangzhou City, Jiangxi Province showed that the total of loan exposure amounted to ¥ 1.80017 billion, of which ¥ 1.77358 billion were secured loans; this represented 98.5% of the banks' total loan exposure. It seemed, therefore, that a majority of loans were backed up by loan securities. On closer scrutiny, however, many were found not to have complied with the Security Law and only 10% of the guarantors had the financial capability to act as guarantors. In the same survey, 1,953 borrowers were investigated and 1,855 of them were indebted to banks, representing 95% of the borrowers. Among these borrowers, ten were large enterprises which were indebted for ¥ 343.29 million. At the same time, these enterprises had also guaranteed the heavy indebtedness of others in the sum of ¥ 191.76 million. Consequently, some of them did not have the means even to repay their workers.[78]

The above facts and figures demonstrate the neglect of many state owned banks to the process, approval and verification of the legal and financial capabilities of guarantors. As a result, many guarantors did not have the financial capability to repay the loan indebtedness. Some enterprises even guaranteed the loans of several borrowers at once, which were manifestly beyond their financial capabilities.

Many banks also neglected the lawfulness and validity of the guarantee contracts they entered into with the guarantors. Some accepted properties as security which was clearly prohibited by law. For example, some borrowers continued to mortgage school or hospital assets and properties as security, all of which were prohibited from being used as loan securities.[79]

In other cases, the banks failed to supervise or monitor their borrowers after making loans to them. When the borrowers failed to repay their debts, then neither were the guarantors willing or able to repay the debts. One court case demonstrated this issue as well as the ineffectiveness of the legal system in providing adequate protection for banks: a car repair factory applied

77. *See* Wang Fuqiang, *Guaranteed Loans are Worrying*, 1 FIN. INFORMATION REFERENCE 39 (1997) (discussing fraud in loan guarantees).

78. De Fu, Xiao Wei, Chen Yong & Lie Zheng, *On Improving the Quality of Mortgages and Guarantees*, FIN. TIMES (London), Jan. 4, 1996, at 2.

79. Zhou Xingce, *Preliminary Discussions on Problems and Suggestions for Secured Loans*, JINRONG SHIBAO [FIN. TIMES] (London) Oct. 19, 1996, at 3.

for a guaranteed loan of ¥ 130,000 from a bank. The loan contract stipulated that the loan should be used for the purchase of car accessories. The guarantor assumed joint and several liabilities for the loan indebtedness. After obtaining the loan, the car repair factory used ¥ 20,000 only to purchase car accessories, the remaining ¥ 110,000 then being used to purchase two cars. The factory later defaulted. When the bank sued the guarantor, the latter argued that it should only be liable for the purchase of car accessories, that is, the loan purpose stipulated in the loan contract. He further asserted that the car transaction amounted to a variation of the loan contract without the written consent of the guarantor, which was required under the Security Law (1995).[80] Such arguments were accepted by the court, and thus, the guarantor was only held to be liable for an amount of ¥ 20,000.[81]

Implementation problems also arose from the registration of the loan securities.[82] For example, when the Security Law was first promulgated in 1995, many government authorities did not establish registration departments so that no responsible authority existed in practice for registration of certain types of loan securities.[83] In addition, even where some state registration authorities existed, they abused the procedure by overcharging to the point where a transaction fee as high as 5% of the mortgaged amount was not uncommon.[84] This high fee posed a practical problem for both the banks and their borrowers as it increased both the transaction and compliance costs for the banks and their borrowers. Clearly, these state registration authorities exploited the registration requirement as a source of revenue.

Besides, many state registration authorities 'compelled' the parties to undertake valuation of loan securities before agreeing to arrange for their registration, even though valuation of loan securities was not a requirement stipulated by the relevant regulations. In many cases, this allowed income to be derived for the valuation agencies, which the authorities themselves had established. Consequently, these authorities also refused to accept valuation reports made by any other agencies in order to create a

80. Security Law, Art.24.

81. Liu Jiuan, *Regulating the Practice of Security, Guarantee and Loans According to Law*, JINRONG SHIBAO [FIN. TIMES] (London), Aug. 7, 1996, at 3.

82. *See* Kang Dingxuan, Zhang Huayu & Liu Yuquan, *Seriously Implementing the Security Law and Protecting the Interests of Commercial Banks*, JINRONG SHIBAO [FIN. TIMES] (London), Nov. 28, 1996, at 3 (analyzing the problems relating to the registration of loan securities).

83. Zhou, *supra* note 79.

84. Tan Shibao, Chen Xiaoqing and Lin Shuangqing, *The Registration Fee of Mortgage Properties Needs to be Regulated*, JINRONG SHIBAO [FIN. TIMES] (London), Oct. 26, 1996, at 5.

monopoly of valuation business for themselves. What is more, these state registration authorities failed to adopt a uniform rate, and thus, they could charge a fee as much as 8% to 10% (or even higher) of the value of the loan securities.[85]

Excessive administrative fees were also imposed by other state authorities to derive revenue for themselves, which also affected the proper implementation of the loan regulations. For example, the State Administration Bureau of Industry and Commerce accepted registration of security documents by charging 2% of the secured amount as a contract administration fee. In extreme cases, they even charged illegally.[86]

Another implementation issue arose from the validity period of the valuation of the loan securities. Sometimes, these valuation reports were only valid for one year and it was imposed by the valuation agencies themselves; in other words, the borrowers were required to undertake a new valuation after the time had expired. Such cumbersome valuation and registration procedures could take up a lot of time if borrowers created securities across different kinds of assets to Chinese banks[87] and they seriously undermined the implementation of loan regulations.

Yet, more implementation problems were associated with the short period for enforcing loan securities imposed implementation problems. Under the Security Law (1995), for example, Chinese banks were required to commence court proceedings within six months of expiry of loan periods, otherwise the loans and guarantees would lose all legal protection.[88] This six-month period was even shorter than the limitation period stated in the General Principles of Civil Law adopted back in 1986.[89] As the obligations of the guarantors would be relieved upon expiry, the banks were 'forced' to sue their borrowers to avoid extinction of their rights by virtue of the lapse of the limitation period.[90] This created pressure on the court system, which found itself 'overloaded' with cases of banks wishing to enforce their loan securities who, in turn, had their own implementation problems: as the bank officers' consciousness of legal issues was still relatively weak, many banks 'lost' their rights with regard to loan securities merely by 'inaction' for six months.

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85. Song Yanlü, *Several Problems in Implementing the Security Law and Suggestions*, JINRONG SHIBAO [FIN. TIMES] (London), Jan. 21, 1996.

86. Tan et al., *supra* note 84.

87. Song, *supra* note 85.

88. Security Law (1995), Arts. 25, 26.

89. Under Art.173 of the General Principles of Civil Law (1986), the limitation period is stipulated to be 2 years.

90. Li Xiaoming, Liu Jingxin & Zhao Ping, *Several Suggestions to Resolve Implementation Problems of the Security Law*, 2 FIN. THEORY AND RESEARCH 46, 47 (1997).

Delayed action by the state owned banks against the guarantors also caused problems because they did not assert their legal rights against the guarantors within the validity period of guarantee. As a result, some guarantors escaped liability while in other cases, the banks, in attempting to assert their rights against either failed to assert their rights in writing or could not produce documentary evidence to prove their rights, thereby enabling these guarantors to evade their liabilities.[91]

'Realization' of loan securities also contributed to implementation problems.[92] For example, some loan regulations required a premium to be paid after auction in respect of land use rights in state grant lands.[93] In practice, some land administration departments required a premium as high as 70% of the market price of the loan securities. Some banks simply had no understanding of such a legal requirement, and only realized the need to pay the premium themselves when they tried to enforce the loan securities.[94]

In theory, while state owned banks were entitled to sell the loan securities by auction if the borrowers defaulted, in practice China had not fully developed the legal infrastructure for realization of these loan securities. As auction markets were not fully established, which made it difficult for the banks to enforce loan securities – a particularly acute problem at local levels.[95]

3. Changes in Loan Regulations After WTO Accession

After China joined the WTO in November 2001, its loan regulations continued to undergo significant changes, both in quantity and quality. This continued emphasis on loan regulation reform could be attributed to the strong desire of the Chinese leaders to reduce the amount of 'non-performing' bank loans to a level low enough for state owned banks to compete effectively with foreign banks after the opening of the banking sector.

A. An Overview of the Loan Regulations Adopted After WTO Accession

China adopted many new administrative regulations after WTO accession. These focused on three key areas: loan risk management, capital adequacy regulation and corporate govern-

91. Wang, *supra* note 77.

92. *See* Zheng Shunyan, *Realization of Mortgagee Rights of Commercial Banks From a Third Eye Perspective – Reflections on Article 53 of the Security Law*, 31 Peking U. Fin. L. J. 30.

93. Measures for Regulating City Real Estates (1994), Art.50.

94. Song, *supra* note 85.

95. Zhou, *supra* note 79.

ance. The reforms included significant changes to the existing Commercial Banking Law (1995), as well as a host of other important administrative regulations.

The first major change to loan regulations after WTO accession consisted of substantial revisions to the Commercial Banking Law. The original version of the Commercial Banking Law required state owned banks to operate on the principles of "efficiency, security, and liquidity."[96] But the new order of priorities was subsequently changed to "security, efficiency, and liquidity." As explained by Duan,[97] this revision reflected the Chinese lawmakers' belief that the principle of security was the most important.

The 2003 revisions also brought the Commercial Banking Law in line with the international standards in response to the Chinese accession to the WTO. One example was the new emphasis on risk management and internal control systems. State owned banks were required to establish and perfect their own risk management and internal control systems in accordance with the newly devised stipulations.[98] China was conforming to international practices in banking regulation through such statutory revision, particularly the Core Principles of Effective Banking Supervision (1997) issued by the Basle Committee, the international banking regulator.

Another significant 2003 revision was related to 'designated' loans of the State Council. Under the old Commercial Banking Law (1995), the State Council could require state owned banks to disburse special loans and they could take remedial measures and devise appropriate methods if these banks suffered any loss arising from such 'designated' loans.[99] Obviously, these were loans of a policy, and not commercial, nature. However, the Chinese lawmakers abolished them in the 2003 provisions, considering such loans incompatible with the commercial banking operations of state owned banks. As pointed out by Huang,[100] this signaled a higher degree of autonomy for state owned banks in their loan business.

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96. Commercial Banking Law (2003), Art.4.

97. Duan Jinglian, *Revisions to the Commercial Banking Law Shall Promote the Reform and Development of Commercial Banks*, 4 JINRONG YU BAOXIAN [FIN. & INS.] 107-109 (2004).

98. Commercial Banking Law (2003), Art.59

99. *Id.* Art.41.

100. Huang Tao, *Shangye Yinhangfa De Xiugai Jinyibu Tuokuan Le Shangye Yinhang GAige He Fazhan De Kongjian [Commercial Banking Law revisions further expanded the scope of reform and development of commercial banks]*, 4 ZHONGGUO JINRONG [CHINA FIN.] 48-50 (2004) .

Finally, the Commercial Banking Law (2003) strengthened the supervision of state owned banks by substantially increasing the penalties that might be imposed on them and their officers for negligence or malfeasance in their loan operations. For example, the revisions increased the maximum fine imposed on state owned banks from ¥ $500,000 to ¥ 2 million.[101] In addition, bank officers could be removed from their posts or barred from engaging in banking work temporarily, for either a specified time or permanently.[102]

China also improved the 1998 model of the five category classification system for bank loans by again emphasizing them in the Guiding Principles on Loan Risk Classification (2002). Of these five categories, the last three, 'inferior', 'doubtful' and 'loss', were categorized as 'non-performing' loans. However, China made two important changes in the new Guiding Principles. First, regulation of the unlawful acts of evading bank debts was strengthened. Banks were to treat those loans as 'concerned loans' if the borrowers maliciously evaded their bank loans through changes in legal entities of their enterprise by way of merger, reorganization, or division.[103] In addition, the new Principles provided the legal basis for loan loss provision for banks' bad debts. The Chinese banks were required to follow prudent accounting standards and the relevant guidelines of the Ministry of Finance and PBOC in order to withdraw loan loss reserve and write off their 'lost loans' accordingly.[104]

As a PBOC officer pointed out, the new Guiding Principles for Loan Risk Classification was clearly a response to China's accession to the WTO and followed international practices. The 'five-category' loan classification' was a risk management method first used by the United States and later became a widely accepted method in market economies including Hong Kong.[105] Moreover, the bank regulators in overseas countries had required the Chinese banks to provide information on the loan classification when the banks set up overseas branches which would, therefore, enable Chinese banks to develop their overseas business and markets.[106]

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101. Commercial Banking Law (2003), Art.76.

102. *Id.* Art.89.

103. *Id.* Art.8.

104. *Id.* Art.30.

105. Shan Yuqin, *Weihe Tuixing Daikuan Fengxian Fenlei Guanli* [*The PRC Banking Sector Fully Implemented The Loan Classification Risk Management at Full Speed Commencing From 1st Jan. 2002*], [CHINA ECON. TIMES], Dec. 26, 2002, at 2.

106. Cheng Meifang, *China Fully Implemented Loan Risk Classification System from 2002*, CITY FIN. NEWS, Dec. 27, 2001, at 1.

In 2002, again in order to strengthen the loan risk management of banks, China also adopted the Guide on Calculation and Provision of Loan Loss Reserve to strengthen the risk management of banks. Under the Guide, the banks were required to calculate and provide adequate loan loss reserve for their 'non-performing' loans in a timely manner.[107] If banks were unable to make such provision immediately, they had to step up their efforts in providing such reserves and in writing off their bad debts within the next few years, but not later than 2005.[108]

In addition, the Provisional Regulations on Information Disclosure of Commercial Banks were adopted in 2002 to strengthen the system of information disclosure. Banks were required to disclose the amounts of different kinds of loans, 'non-performing' loans and amounts of loan loss provision in their accounting reports.[109] Moreover, they had to disclose the total amount of transactions with 'connected parties', and, in particular, details of 'substantial transactions' with such 'connected parties'. 'Connected parties' included such natural persons as individual bank officers, shareholders and close relatives of such bank officers and shareholders as well as organizations like corporate shareholders of banks and organizations controlled by individual bank officers and shareholders. On the other hand, 'substantial transaction' meant an amount exceeding ¥ 30 million or 1% of the aggregate net asset of the commercial bank involved.[110] These provisions served to deter bank officers from granting illegal loans to 'connected parties', one important cause of 'non-performing' loans.

On the basis of this provisional regulation, on December 8, 2006, China then adopted the Regulations on Information Disclosure of Commercial Banks, which took effect on July 3, 2007.[111] Therefore, the banks had to disclose in their accounting reports both their business volume of 'connected transactions', and details of major 'connected transactions'. 'Connected transactions' meant transfers of resources and assets between banks and their 'connected parties.'[112] They were also required to disclose the details of different kinds of loans, including credit loans, guaranteed loans, secured loans and pledged loans as well as

107. Guide on the Calculation and Provision of Loan Loss Reserve (2002), Art.2.

108. Yin Tao, *Yanghang Fabu Daokuan Sunshi Zhunbei Jiti Zhiyin* [*China Central Bank Promulgated Guide on the Calculation and Provision of Loan Loss Provision*], ZHONGGUO ZHENGQUAN BAO [CHINA SEC. NEWS], Apr. 26, 2002, at 1.

109. Provisional Regulations on Information Disclosure of Commercial Banks (2002), Art.15.

110. *Id.* Art.14.

111. For full text regulations on information disclosure of commercial banks, *see* JINRONG SHIBAO [FIN. TIMES] (London), July 3, 2007, at 1.

112. *Id.* Art.14, at 1.

those of 'non-performing' loans on the basis of the loan risk classification.[113]

Similarly, the Guide on Internal Control of Commercial Banks (2002) strengthened the internal management of banks in their loan business and attempted to deal comprehensively with problems of internal control. Obviously, this was adopted on the implementation experience of the Notice on Guiding Principles of Strengthening the Internal Control Systems of Financial Institutions (1997) considered earlier. As pointed out then, some banks did not strictly follow the approval and verification process set out in the regulations before granting loans, while others failed to supervise or monitor their borrowers after making loans. Then, on July 3, 2007, China went on further to adopt the Guide on Internal Control of Commercial Banks.[114] Under the Guide, banks were required to establish a unified system of authorization and operational regulations, which set out clearly the standards of operations and 'due diligence' at different stages of making loans, including the investigations beforehand, verification during the process, and inspection after making loans.[115] Banks also had to deal with 'connected persons' on the basis of commercial principles and any bank officers with conflicts of interest were not to be involved in such approval and verification process.[116] They had to verify and monitor the loan purpose, and prevent the borrowers from changing the loan purpose with such means of financing or refinancing through discounting and acceptance of negotiable instruments.[117] They also had to prevent frauds by verifying the eligibility of borrowers, the truthfulness of application materials, and completeness of the loan contracts. In addition, banks were required to establish systems to monitor the quality and quantity of loans, detect and give warnings on potential 'non-performing' loans, analyze the causes of 'non-performing' loans, and formulate policies to resolve the loan risks involved.[118] Moreover, they had to lay down detailed standards and procedures for loan risk classification to prevent the concealment of 'non-performing' loans and ensure the truthfulness of loan quality and quantity.[119] Clearly, the above regulations rep-

113. *Supra* note 111, Art.15, at 1.

114. The full Chinese text of the Guide on Internal Control of Commercial Banks (2006) is available at http://www.chinainfobank.com.eproxy3.libhku.hk/IrisBin/Text.dll?db=FL&no+1.

115. *Id.* Art.43

116. *Id.* Art.47

117. *Id.* Art.48

118. *Id.* Art.50

119. *Id.* Art.51

resented a key area of regulatory reforms undertaken by China after WTO accession; namely, loan risk management.

In addition, in 2004, China adopted the Management Regulations on Capital Adequacy of Commercial Banks to bring the capital adequacy ratios of state owned banks in line with international standards. Under the Regulations, the capital adequacy ratios of banks could not be less than 8%[120] and this minimum had to be met by July 1, 2007. In order to achieve it, banks had to formulate and implement realistic plans during the transition period.[121] Otherwise, the China Banking Regulatory Commission was entitled to take all necessary rectifying measures, including compelling the relevant banks to change their personnel or even impose orders of takeover, reorganization, and closure.[122] There was further revision of the Management Regulations on Capital Adequacy of Commercial Banks in December 2006 to bring it in line with new international standards of capital adequacy.[123] By requiring Chinese banks to keep a minimum amount of capital in operating their loan business, these regulations help improve their 'security'.

The final major area of regulations adopted by China after its accession to the WTO focused on corporate governance. In 2004, with a view to strengthening the corporate governance of state owned banks, China also promulgated the Guide on the Reform and Supervision of Corporate Governance of the Bank of China ('BOC') and the China Construction Bank ('CCB').[124] This required these two state banks to control their ratios of 'non-performing' loans within the range of 3% to 5%. They also had to comply, of course with the above mentioned Management Regulations on Capital Adequacy Ratios. The banks also had to take all necessary steps to control the risks of concentrating their loans on one single borrower. Starting from 2005, the ratio of the banks' loan balance of one single borrower to their net bank asset balance was not to exceed 10%. By the end of 2005 the banks' provision for 'non-performing' loans also had to reach 60% for BOC and 80% for CCB and had to further increase by the end of 2007. In any case, they were also required to step up

120. Management Regulations on Capital Adequacy of Commercial Banks (2004), Art.7.

121. *Id.* Art.53.

122. *Id.* Art.41.

123. For the official explanation on revisions introduced in 2006, *see Speech of Chairman Liu Minkan in planning meeting for Chinese banks implementing new capital adequacy requirements*, available at <http://www.cbrc.gov.cn/chinese/home/jsp/docView.jsp?docID=2006123E5072E1E2E67528FF6EB32D91A54100>.

124. For the full text of the Guide on the Reform and Supervision of Corporate Governance of the Bank of China and the China Construction Bank (2004), *see* JINRONG SHIBAO [FIN. TIMES] (London), 12 Mar. 2004, at 3.

their efforts to dispose altogether of their 'non-performing' loans, in particular by seriously dealing with them and submitting a preliminary report to the China Banking Regulatory Commission by the end of 2004.

In retrospect, the Guide has its roots in the 'Decisions on Several Issues of Perfecting the Socialist Market Economic System' promulgated on October 14, 2003.[125] The Decisions had called for selecting qualified state owned banks to undergo 'shareholding' reform, which then paved the way for their ultimate listing in securities markets. As a result of the Guide, China in December 2003 injected US$45 billion from its foreign exchange reserves into the China Construction Bank of China and the Bank of China in order to improve their capital adequacy ratio. The final step was taken towards shareholding reforms of the two banks by laying down the detailed debt ratios and time frames that these two banks should attain to prepare themselves for listing in securities markets.

As mentioned earlier, the Guide on the Reform and Supervision of Corporate Governance of BOC and CBC (2004) also required the two 'designated' state owned banks to focus on four reform goals: improving their management system, perfecting their governance structure, changing their operation mechanism, and improving their overall performance and effectiveness. Moreover, within three years they were to strive to transform into modern shareholding commercial banks which would enjoy a satisfactory capital adequacy ratio and a sophisticated internal control system, operate their business prudently, provide good service and efficiency, and become internationally competitive.[126] Through such 'shareholding' reform, these two designated state owned banks should attain a new level in their corporate governance standards.[127]

Eventually in October 2005, the China Construction Bank was successfully 'listed' on the Hong Kong Stock Exchange, being the first state owned bank to complete the new reform strategy.[128] It was followed by the Bank of China in June 2006,[129] and

125. For the full text of the Decisions on Several Issues of Perfecting the Socialist Market Economic System (2003), *see* GUIDEBOOK ON CHINESE COMMUNIST PARTY GENERAL DECISIONS ON SEVERAL ISSUES OF PERFECTING THE SOCIALIST MARKET ECONOMIC SYSTEM) (2003).

126. Guide on the Reform and Supervision of Corporate Governance of the Bank of China and the China Construction Bank (2004), at para.2.

127. *Id.* at para.3.

128. David Barboza, *IPO of China Bank Marks a Watershed*, INT'L HERALD TRIB., Oct. 27, 2005, at A1.

129. David Barboza, *Bank of China's Offering Soars 15% in First Day*, N.T. TIMES, June 2, 2006, at C3.

then Industrial and Commercial Bank in October 2006.[130] Thus, three out of four Chinese state owned banks were successfully listed in the stock market, which demonstrated the success of the new reform strategy.

B. Achievements of the Loan Regulations Adopted After WTO Accession

As one can see, the regulatory reforms undertaken after WTO accession were successful in bringing the Chinese loan regulation in line with international practices, lowering the amount of 'non-performing' loans, and improving the internal control systems of state owned banks. The regulations therefore enhanced the state owned bank competitiveness before the full opening of the Chinese banking sector at the end of 2006. Viewed in another perspective, the WTO accession impacted on loan regulation most significantly by 'pressuring' China to complete all regulatory reforms before the end of 2006.

In particular, the introduction of these new loan regulations also contributed successfully to the reduction of the amount of 'non-performing' loans. For example, by the end of June 2005, the percentage of all 'non-performing' bank loans was around 10%, a reduction of 3.95% from the start of the same year.[131]

C. Implementation of Loan Regulations After WTO Accession

Despite such success, loan regulations were limited in their implementation by similar problems which existed in the 1990 loan regulations described earlier. These included, in particular, the ineffectiveness of the court system, the problematic registration of loan securities, and the prevalence of illegal and unenforceable mortgages.

To begin with, court proceedings were not an effective means of recovering loan indebtedness as they were expensive and slow. Banks also found it difficult to get judgments in their favor and even if they succeeded, execution of these judgments was difficult because court officers could not effectively lay claim to the borrowers' assets, either because of loan resistance or corruption of local officials. For example, although some banks applied to the courts for preservation orders on their debtors' properties, when the court officers and bank officers attempted

130. Jane Macartney, *Chinese Bank Set to Raise $21Bn in World's Biggest IPO*, The Times (London), July 18, 2006, at 66.

131. Reuters, *Economy is Robust, Says First Report on Stability*, S. China Morning Post, Nov. 8, 2005, at A11.

to execute court orders, they were resisted or even attacked by debtors' employees.

In other cases, the banks could not execute judgments obtained against creditors because of the interference of local officers. In yet more cases, as referred to earlier, the banks, for various reasons, wasted a lot of resources in court proceedings only to recover a tiny amount of debt. The debtors either covered up their assets or had none left for execution; judges were inefficient at best or incompetent at worst, resulting in delays in court proceedings and low completion rates of court proceedings; in addition, the courts charged the banks a variety of fees at different stages of the court proceedings.

The problem of ineffective court execution is exemplified by a survey conducted by the People's Bank of China in Haozhou City. Up until April 2003, the four local banks in that city applied for court execution in 247 cases involving a total amount of ¥ 164.08 million awarded by the courts. However, the amount recovered from court execution was only ¥ 7.16 million, which represented only 4.3% of the total. Moreover, the banks had to incur ¥ 1.13 million in costs for executing such court judgments.[132]

In a similar vein, registration of loan securities remained a thorny issue after the WTO accession. In this regard, a survey of banks conducted by the People's Bank of China Chengdu Branch in 2004 revealed that registration of loan securities caused problems in various ways: as demonstrated earlier, these included diversity of registration departments, complicated registration procedures, a long registration period and the lack of a uniform standard of registration fee. These not only increased the financial burdens of the borrowers in registering their loan securities, but also created difficulties for Chinese banks wishing to comply with the loan regulations.[133]

Finally, the prevalence of 'illegal' or 'unenforceable' mortgages created over properties that either did not exist or could not be disposed of by the borrowers, as well as the neglect of many banks in verifying the legal and financial capabilities of the guarantors and the checking of the lawfulness and validity of the

132. Xu Shaowen, *Danquan Shangye Yinhang Qingshou Chuli Buliang Daikuan De Nanchu He Jianyi* [*Current Problems Faced by Commercial Banks in Recovering and Disposing Non-Performing Loans and Some Suggestions*], 8 JIANRONG CANKAO BAOGAO [FIN. REFERENCE] 72 (2004).

133. People's Bank of China, Chengdu Branch Research Group, *Xindairen Quanli FAlu Baohu De Xianzhuang Ji Sikao – Dui Sichuan Sheng Befen Jinrong Jigou De Diaocha* [*Current Situation and Reflection of Legal Protection of Creditors' Rights – a Survey of Some Financial Institutions in Sichuan Province*], 8 JINRONG CANKAO BAOGAO [FIN. RESEARCH REP.], 1, 5 (2005).

guarantee contracts, continued to affect adversely the implementation of loan regulations after the WTO accession.[134]

4. *Future Reform of Chinese Loan Regulations: Some Critical Observations*

In sum, reform of loan regulations overall in China took four major strategic directions. First, the regulations took policy loans away from state owned banks so that they could focus on commercial loans. Second, the regulations abolished the credit plans systems as a means of managing bank loans and replaced it with a risk management system of asset liability ratios. Third, they introduced various measures to reduce the bank risk in operating bank loans. Fourth, they encouraged the banks to take loan securities. All in all, these loan regulations improved the operational efficiency of Chinese banks in their loan business to a standard compatible with those of commercial banks in developed economies.

However, in order to improve loan regulations further, China needs to strengthen reforms in several areas. To begin with, more regulations are required to improve the registration system of loan securities. For instance, China could lower the registration fee for securities and lengthen the validity period for registration of securities, perhaps from one year to three years. Such changes would simplify administrative procedures and reduce both the costs of the banks and those of their borrowers in registering their loan securities.

Furthermore, clearer guidelines are necessary for registration authorities on the responsibilities of valuation agencies, the use of valuation reports and the validity period of registration. It has been suggested that China should centralize all registration authorities into one consolidated authority so that the banks and their borrowers can register their securities at one place. This may solve the problem of multiple registrations and multiple valuations. In addition, more regulations are required for uniform scales and standards for registration and valuation. These are likely to prevent authorities from charging banks and borrowers exorbitant fees for registering loan securities.[135] Nevertheless, as this article indicates, China has not adequately addressed these issues and as a result, registration of loan securities has continued

134. *See*, e.g., Gao Liangyou and Zhan Chuihong, [*Risk Prevention of Defective Guaranteed Loans and Their Remedies*], 5 FIN. REFERENCE 9 (2002); Zhang Jixin, WOGUO YINHANGYE DANBAO DAIKUAN XIANCUN WENTI JIQI FALU SIKAO [*Existing Problems of Loan Guarantees in the Chinese Banking Sector*], 10 JINRONG YU BAOXIAN [FIN. & INS.] 92 (2004).

135. Song, *supra* note 85.

to affect the implementation of loan regulations since the WTO accession.

The legal infrastructure also needs to be further developed to help China's banks realize their loan securities. It has been suggested that the banks should strengthen their relationships with the judiciary and State Bureau for Industry and Commerce in order to develop regional auction markets and facilitate the realization of their rights in the loan securities. Such action may alleviate the remaining practical problems.[136]

China also needs to improve the approval and verification process for borrowers and guarantors in bank loans. While the country has stepped up efforts to reform the internal control and loan management systems of banks since WTO accession, many enterprises which are on the verge of bankruptcy are stopping production, or have insufficient assets to repay the loan indebtedness, yet they are still nevertheless providing guarantees for other borrowers.[137] This makes it difficult for the banks to recover their loans and increases the risks of not having their rights realized at the end.

Finally, effective implementation of loan regulations requires a critical mass of high-quality bank officers and legal professionals.[138] To this end, state owned banks need to improve the quality of their bank officers, who must be made aware of the content of the loan regulations and of their strict compliance. Indeed, incentive schemes for bank staff may be needed to encourage compliance with these loan regulations.[139]

5. *Changes in Loan Regulations: Implications for Legal Reform Strategy in China*

The change in loan regulations also sheds light on China's legal reform strategy. As this article indicates, many loan regulations adopted after WTO accession were similar in content to many regulations promulgated in the 1990s. In turn many of those 1990s regulations were developed from those promulgated during the 1980s. The term I have coined for this legal reform

136. Zhou, *supra* note 79.

137. Tian Yuxian, DANBAO DE ZUOYONG BURONG HUSHI [*The Functions of Guarantees Cannot Be Neglected*], JINRONG SHIBAO [FIN. TIMES] (London), Oct. 2, 1996, at 3.

138. On the issue of lack of quality bank staff and professions for the implementation of the banking regulations, *see e.g.,* Lee Xiaolan, Shi Yuejin & Quo Ming, [*On Legal Construction for Financial System Reform*], 2 [ECON. L. & BANK BUS.] 46 (1991); Qin Chijiang, *Guifan Jiedai Xingwei Chongjian Xinyong Zhidu – Xuexi Daikuan Tongze Shixing De Jidian Tihui* [*Regulating Loan Conduct And Re-Establishing Credit System – Several Reflections On Studying The General Principles on Loans (Tentative)*], [CHINA FIN.], Nov. 1995, at 13-15.

139. Zhou, *supra* note 79.

strategy is 'legal gradualism', a term adapted from the term 'economic gradualism' commonly used to describe the economic reform strategy in China.[140]

It is submitted that the concept of 'legal gradualism' displayed in these loan regulations comprises two distinct features: incremental reforms and a pragmatic approach. In the case of the former, the continuity in the loan regulations adopted during the past three decades is evident if we compare their content. For instance, the 1996 General Rules on Loans were clearly adopted on the basis of the 1985 Regulations on Loan Contracts. Likewise, the 1995 Security Law was obviously developed on the basis of the 1981 Economic Contract Law, the 1986 General Principles of Civil Law and various 'bank-specific' 1980 loan regulations of individual Chinese banks which contained provisions for the creation of loan securities. What is more, the goals of General Rules on Loans and Regulations on Loan Contracts were the same, namely, stipulating the format and contents of loan contracts.

In explaining 'economic gradualism' in China, Wang asserted that the concept could be understood from two perspectives. On the one hand, the Chinese economic reform was gradual in the sense of 'the evolving goals revealed from its dominant beliefs, its shifting focus on dismantling the old system and developing the new system'. On the other hand, it was gradual from the perspective of 'adjusting the planning system while rapidly developing the market'.[141] Clearly, Wang was referring to the gradualist approach adopted by China in shifting from a planned economy to a market economy.

In a similar vein, Liou argued that the Chinese leaders' decision to adopt a gradual approach in economic reform was not made on the basis of recommendations from economists in the developed world, but rather on the painful experience of the country. Liou asserted that, from the failures of the Great Leap reforms undertaken by Mao Tsetung, Chinese reform leaders learned that radical policies do not work. Therefore, the country deliberately implemented economic policies that were gradual in nature so as to minimize risks and promote certainties in the reform process.[142]

The same 'risk aversion' mentality of Chinese leaders also seems to be reflected in the 'legal gradualism displayed in the

140. *See* WANG HUI, THE GRADUAL REVOLUTION (Transaction Publishers 1994); *see also* KUOTSAI TOM LIOU, MANAGING ECONOMIC REFORMS IN POST-MAO CHINA (Praeger Publishers 1998) for an analysis of economic gradualism in China.

141. *See* WANG, *supra* note 140, at 187.

142. *See* Liou, *supra* note 138, at 142.

loan regulations. Many Chinese leaders have experienced the 'lawless' state of the country during the Cultural Revolution when most Chinese laws were either abolished or 'suspended'. It is submitted that such experiences probably made them more cautious and skeptical about changing the laws frequently and rapidly.

The second distinctive feature of 'legal gradualism' as displayed in the loan regulations is a pragmatic approach in dealing with reform problems. This pragmatic approach implies that no rigid or fixed plan or systematic ideology should exist for carrying out legal reforms. This can be attributed to the attitude of Deng Xiaoping, the Chinese leader who introduced the economic reforms in the late 1970s, and described his approach as one of '*mozhe shitou guohe*' ('crossing the river by touching the stones').

In the loan regulations, we can discern a similar pragmatic approach in the improvement of their 'technical' quality. In the past, many Chinese legal scholars believed that Chinese laws were 'non-technical' to ensure their 'flexibility'. For example, Guo considered such a 'general' approach (that is, an approach based on broad principles and not detailed rules) as reflective of the fundamental principle of China's law drafting. Laws should be both 'general' (*yuanzexing*) and 'flexible' (*linghuoxing*).[143] Guo went further in justifying the principle by arguing that it was 'more appropriate to be general than to be detailed'.[144] Obviously, some academics considered the 'general' approach as compatible with the pragmatic needs of the country, such as the low educational level of the general population and the wide variations in local circumstances.

On the other hand, Western scholars such as Keller, while also finding a 'broadly drafted' or 'indeterminate' language used in the Chinese legislation, are more critical of the phenomenon. Keller maintained that this approach gave such a wide discretion to government officers in interpreting the laws that they could virtually do whatever they saw as appropriate under different circumstances. In reality, this meant that the 'meaning attached to legislative language should shift according to the context.'[145] Otto claimed further that this lack of clarity in Chinese legislation was incompatible with the concept of rule of law, which

143. For a discussion of these fundamental principles, *see* Guo Daohui, *A Discussion of the Synthesis of Generality and Flexibility in Legislation*, COMMENT. ON LEGAL STUD. 15 (1987).

144. Guo Daohui, CHINAS LEGIS. SYS. 136 (1988).

145. Perry Keller, *Sources of Order in Chinese Law*, 42 AM. J. COMP. L. 711, 752 (1994).

needs 'clarity, systematic stability and finality'.[146] Yet he was optimistic that if more 'technical-legal' efforts were made by China to enhance its legislative quality, it would lead to the emergence of a new 'breed' of Chinese laws that were 'professionalized' and 'depoliticized'.[147]

Indeed, a 'non-technical' approach to legal drafting was no longer 'sustainable' given the increased integration of the Chinese economic system with the world economy. It was becoming clear that the Chinese legal system, therefore, needed now to provide legal certainty to foreign investors. As demonstrated in the text of the Chinese loan regulations adopted since the 1990s, the country has modeled loan regulations such as the Commercial Banking Law on their counterparts adopted in market economies. As a result, the technical quality of the new loan regulations has improved considerably on those adopted during the 1980s so that they have truly represented a new breed of Chinese laws that, in Otto's terminology, are 'professionalized' and 'depoliticized'.[148]

Therefore, the empirical evidence seems to challenge the validity of Keller's earlier hypothesis. In fact, his observation of 'wide discretion' may well be rendered 'obsolete' now by the Chinese accession to WTO. As the integration of China with the world continues, pragmatism is likely to require its lawmakers to keep on improving the technical quality of the legislation in accordance with international standards.

Overall, during the past thee decades, the concept of 'legal gradualism' provides a framework with which to understand the legal reform strategy used by China in developing its loan regulations, and the changing process of Chinese law. While the focus of this article has been on loan regulations, it is submitted that the concept of 'legal gradualism' may be generalized to other areas of Chinese law. For example, Lichtenstein's studies on Chinese company law reforms during the 1980s and early 1990s revealed a similar 'gradualist' lawmaking pattern.[149] Likewise, Josephs, in her studies of Chinese labor law reforms during the same period, found that the 'post-Mao' leadership had adopted a

146. Jan Michiel Otto, *Conclusion: A Comparativist's Outlook on Law-Making in China*, *in* LAW-MAKING IN THE PEOPLE'S REPUBLIC OF CHINA 215, 222 (Jan Michiel Otto, Maurice V. Polak, Jianfu Chen & Yuwen Li eds., Kluwer Law International 2000).

147. *Id.* at 228.

148. *Id.*

149. Natalie G. Lichtenstein, *Law in China's Economic Development: An Essay from Afar*, *in* UNDERSTANDING CHINA'S LEGAL SYS. 274 (C. Stephen Hsu ed., New York University Press 2003).

gradual approach in emphasizing the law in these reforms.[150] It is hoped that a wider acceptance of the concept can further improve our understanding of the change process in others areas of Chinese law.

150. HILARY K. JOSEPHS, LABOR LAW IN CHINA: CHOICE AND RESPONSIBILITY 147 (Butterworth Legal Publishers 1990).