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# A CRITICAL ANALYSIS OF THE LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON INDUSTRIAL ENTERPRISES OWNED BY THE WHOLE PEOPLE

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## I. INTRODUCTION

On April 13, 1988, the Seventh National People's Congress (the NPC) of the People's Republic of China (PRC) adopted the Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People ("Enterprise Law")<sup>1</sup> after eight years of drafting, examinations, and revisions. "Industrial Enterprises Owned by the Whole People," commonly known as state enterprises, play an extremely important role in the PRC's economy. In 1985, 7,900 large and medium-sized, and 85,805 small state enterprises accounted for approximately seventy percent of the PRC's total value of production.<sup>2</sup> The Enterprise Law, which is applicable to most of these enterprises<sup>3</sup>, will have a heavy impact upon the PRC's economy.

The Enterprise Law was drafted with the goal of improving the efficiency of the state enterprise sector of the economy, which for many years has been bogged down by inflexible control from the State and the Chinese Communist Party (the CCP). The law aims to create a new economic system based on the principle of separat-

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1. Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People (1988) China Ls. for Foreign Bus. (CCH Austl.) ¶ 13-534 [hereinafter Enterprise Law]

2. Sensenbrenner, *The Evolving Enterprise*, CHINA BUS. REV., Mar.-Apr. 1987, at 35.

3. The Enterprise Law is applicable to state enterprises which engage in transport, post and telecommunications, geological prospecting, construction and installation, commerce, foreign trade, goods and materials, agriculture, forestry, and irrigation. Enterprise Law, *supra* note 1, art. 65.

ing enterprise management from state ownership. Under this system, the state enterprises will be owned by the State in theory, but the power and responsibilities of enterprise directors will be increased, while the control of the State and the CCP over the enterprises will be curbed. With less control by the State and the CCP, the operation of the state enterprises will be guided by both market forces and economic plans. The introduction of market forces is expected to increase the efficiency and productivity of state enterprises, and, ultimately, the economy in general.

This article first outlines the legislative history of the Enterprise Law and discusses the characteristics and the problems of the former state enterprise system. It then describes the two major proposals for the reform of this system; summarizes the Enterprise Law, which adopts one of the two proposals; and discusses the shortcomings of the law.

## II. LEGISLATIVE HISTORY

The Enterprise Law has a long legislative history. Although the first draft was completed in October 1980, the law was not adopted until April 1988. The CCP played an important role throughout the drafting, redrafting, and enactment of the law, a process which was marked by an emphasis on practicality and an increasing tendency toward democracy.

### 1. Chronology of Legislation

The drafting of the Enterprise Law was initiated by Deng Xiaoping, who emerged as the uncontested leader of the PRC after the fall of the Gang of Four. At a meeting of the 11th CCP Central Committee, Deng delivered the well-known speech, "Emancipate the Mind, Seek Truth from Facts, and Unite as One to Look Forward", urging fellow party members to carry out reforms of the economic and political systems of the PRC based on pragmatic principles. Deng believed that the state enterprise system was a system that needed to be reformed. In response to his speech, Zhao Ziyang, the reform-minded then Premier of the State Council, instructed various central authorities in August 1980 to begin studying and drafting a new law applicable to state enterprises. In October 1980, the Outline of the State-owned Factory Law was completed.

The Eleventh CCP Central Committee then decided that economic reforms needed to focus upon the rural areas. From 1981 through 1983, the drafting of the Enterprise Law was temporarily suspended. However, during the same period, the State Council and other central authorities promulgated the following four sets of provisional regulations applicable to state enterprises in order to fill

the vacuum caused by the lack of applicable laws: Provisional Regulations of State-owned Industrial Enterprises; Provisional Regulations on the Work of the State-owned Factory Directors; Provisional Regulations on the Congresses of the Staff and Workers of the State-owned Industrial Enterprises; and Regulations on the Work of the CCP Grassroot Organizations of the Industrial Enterprises.

After three years of emphasis on rural reforms, the Twelfth CCP Central Committee adopted the "Decision on Reform of the Economic Structure", vigorously pushing forward the development of urban reforms. It was decided that the power of state enterprises should be expanded and that enterprise directors should be given more power to manage these enterprises. From 1985 to early 1987, three different drafts were submitted to the NPC Standing Committee for examination and approval. All three attempts failed because the members of the committee could not agree on the roles to be played by the enterprise directors, the CCP grassroot organizations, and the labor unions within the state enterprises.

Developments in the CCP at the national level in 1987 and 1988 paved the way for the eventual passage of the Enterprise Law. The Thirteenth CCP National Congress approved the theoretical basis of the Enterprise Law: The separation of enterprise management from state ownership. In January of 1988, the Politburo of the CCP approved a draft of the Enterprise Law, indicating that it would soon be passed by the NPC. Finally, the 6th NPC Standing Committee discussed, revised, and submitted the draft to the Seventh NPC, which formally adopted it on April 13, 1988.

## 2. Experiments with the Principle behind the Enterprise Law

During this entire period of time when the Enterprise Law was drafted, examined, and revised, the principle behind the Enterprise Law, the separation of enterprise management from state ownership, was put into practice in a number of selected state enterprises throughout the PRC. In May 1984, for example, the general offices of the central authorities and the State Council jointly issued a circular selecting a number of enterprises in Dalian, Changzhou, Beijing, Tianjin, Shanghai, and Shenyang in which to carry out pilot projects implementing this principle. Later, the scope of this project was expanded. Under this experimental system, the State continued to own an enterprise's assets and funds, but its director had the right to run it as he saw fit.

This pioneering system of more independent state enterprises led by more powerful enterprise directors drew numerous criticisms from conservatives in the PRC. In 1985, some directors were attacked by the press for abusing their power by indiscriminately issu-

ing excessive bonuses, disregarding the policies set down by the CCP, and unreasonably discharging trade union chairmen from their posts. These general criticisms led to political attacks. In 1986, at a national economic work conference, some cadres attacked the enterprise directors' abuse of power, and proposed the reestablishment of leadership by the CCP in state enterprises. The enterprise directors who wielded expanded powers were accused of being part of the ideological trend of bourgeois liberalism. Despite these negative criticisms, the state enterprises in these pilot projects produced generally favorable economic results, and significantly increased their operational efficiency.

In a movement parallel to these pilot projects, unprofitable state enterprises, mainly in the service sector, were leased or contracted out to collectives or individuals to experiment with the principle of the separation of enterprise management from state ownership. Under this experimental system, the State retained ownership of the property and funds of the enterprise. The collectives or individuals took possession of and operated these assets owned by the State, and paid an agreed upon percentage of profits to the State. As a result of such leasing or contracting, the leadership of the enterprises was divorced from the government authorities which had previously supervised the enterprises. The leadership was also divorced from the CCP as the enterprises were now run by collectives or individuals not related to any government authorities.

This experiment was a success. Many of the leased state enterprises emerged from the red after they had been leased to collectives or individuals. By October of 1985, of the total 85,805 small state enterprises involved in retail, commerce, and catering services, more than 49,000 had reportedly been leased to collectives, and some 7,300 had been leased to individuals.<sup>4</sup> With the success of these service sector experiments, even small and medium-sized industrial enterprises were leased or contracted out. In Wuhan, for example, thirty-five small industrial enterprises were reportedly leased out.<sup>5</sup> In October of 1986, the first medium-sized industrial enterprise, an automobile engine factory, also in Wuhan, was leased to ten Chinese investors.

Encouraged by the success of these experiments which began in 1984, the Enterprise Law was finally approved by the CCP and formally adopted by the NPC in 1988.

### 3. Tendency Toward Democracy

During the period of experimentation, the central authorities

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4. Sensenbrenner, *supra* note 2, at 36.

5. *Id.*

also exerted unprecedented efforts to solicit public opinion on how the law should be revised. The central authorities organized numerous investigative missions to collect opinions from all parties which would be potentially affected by the law. In July 1984, for example, leading cadres of the central authorities led an "Enterprise Law Investigation Group" to three provinces in Northeast China to collect the views of provincial, city, and national enterprise officials on the draft law. In addition, in 1985, the State Council issued the State-Owned Industrial Enterprise Law (Draft) to all provinces, cities, and districts; all departments of the State Council; and some selected state enterprises, to collect more opinions.

After the Politburo of the CCP approved the draft law, making it likely that the law would eventually be passed, public opinion on the draft law was solicited even more intensively. On January 6, 1988, the General Office of the NPC Standing Committee and the General Office of the State Council issued a circular to solicit opinions from the general public on the draft law. On January 12, 1988, the draft law was published in all the major newspapers in the PRC. At the local level, Standing Committees of the People's Congresses and people's governments of various provinces, autonomous regions, and municipalities held numerous symposiums to discuss the draft law. At the central level, authorities also organized similar symposiums for the same purpose. For instance, the Legislative Affairs Commission of the NPC Standing Committee, the State Economic Commission, and the State Commission for Restructuring the Economic System held six separate symposiums. At these meetings, the central authorities had the opportunity to receive opinions from leading cadres of state enterprises, specialists of government departments, economists and attorneys. At the same time, the central authorities received thousands of letters containing various suggestions for the draft law. All the opinions expressed in these symposiums and letters were given extensive coverage by all the major newspapers.

The draft law was then revised based on these suggestions. It was generally felt that the law should include stipulations on the workers' positions, rights, and obligations. As a result, Article 9 was added, which provided that "[t]he State shall safeguard the status of staff and workers as the masters of the State and their legal rights and interests shall be protected by the law." To further protect the workers' interests, Article 46 was added to provide that enterprise directors should support the representative assemblies of workers and trade unions, and implement the resolutions passed by such assemblies. Article 49 was added to give workers the right to the democratic management of state enterprises, as well as the rights to express their suggestions, to receive labor protection, in-

surance, and benefits, and to criticize and file charges against their superiors in the enterprises.

Based on the suggestions of certain groups involved in these symposiums, including the All-China Trade Union Council, Article 11 was added to provide that an enterprise trade union shall represent and protect the workers' interests and shall organize the workers to participate in the democratic management of the enterprise.

Some symposium attendees suggested that the law should safeguard the rights and interests of women workers, who comprise one third of the PRC's work force. This prompted the drafters to add the portion of Article 49 which states that "[f]emale staff and workers shall be entitled to receive special labor protection and labor insurance in accordance with State regulations."

It was also suggested that in applying the law to state enterprises located in regions populated by minorities, special consideration should be given to the interests of the minorities. Based on this suggestion, Article 68 was added to provide that:

The Standing Committee of an Autonomous Region People's Congress may formulate implementing measures in accordance with the principles of this Law and the Law of the People's Republic of China on Regional Autonomy for Minority Nationalities and, taking into account special local circumstances, shall submit these measures to the Standing Committee of the National People's Congress for its records.

#### 4. Observations from Legislative History

Three observations can be made from the relatively long legislative history of the Enterprise Law. First, PRC legislation depends heavily on the policy decisions of the CCP. For example, Deng's speech on economic reforms at the Eleventh CCP Central Committee initiated the drafting of the law. Then the Eleventh CCP Central Committee's decision to focus on rural reforms suspended the drafting of the law for three years. Later, the Twelfth CCP Central Committee's decision to focus on urban reforms resurrected the drafting process. Finally, the Thirteenth CCP National Congress' approval of the underlying principle of the separation of enterprise management from state ownership, and the approval of the draft law by the CCP's Politburo, sped up the legislative process and enabled the law to be passed within a few months.

Second, the pragmatic principle that "it doesn't matter whether the cat is black or white as long as it catches mice" is a key to understanding the operation of the PRC legislative process. In this instance, the principle behind the Enterprise Law, the separation of enterprise management from state ownership, was put into practice in state enterprises leased or contracted out to individuals and collectives, and in the pilot projects involving certain state en-

terprises, where enterprise directors were given more power. Because these pilot projects and experiments were a success economically, the principle behind the Enterprise Law proved to be workable, making the NPC more willing to adopt the Enterprise Law.

Third, this is the first time in which the central authorities have carried out an extensive process of soliciting public opinion on an important law from a wide range of individuals and organizations. This may very well signal the beginning of a new era in which PRC laws are to be passed in an increasingly democratic fashion.

Analysts of the development of the PRC legal system should keep these observations in mind when analyzing the legislative process for other new laws of the PRC.

### III. THE FORMER STATE-PLANNED ENTERPRISE SYSTEM

Prior to any experimentation with the concept of separating enterprise management from state ownership, and under the former state-planned enterprise system, the State owned and managed all enterprises. The central government managed the large enterprises of major industries. The other enterprises, of various sizes, were managed by the provincial, the municipal or the local governments, depending on the importance and the size of the enterprises. The word "State" may mean any one of these government levels.

The central government drew up an overall plan for all state enterprises in China. This overall plan was divided up into component plans, some of which applied to enterprises directly while the rest applied to the provincial and municipal governments. These lower levels of government further divided up these component plans. Some of the plans were directly applicable to enterprises, while the others governed the local levels of government. These local government units finally divided up their plans among the enterprises they managed.

Though different levels of government were involved, one principle remained the same—each enterprise was managed by a supervisory government unit. Through these units, the State dictated the plan to each enterprise, supplied it with factors of production, and collected the planned products from the enterprise. The State received all the profits and absorbed all the losses. All investment decisions were also included in the plans. Market forces were, to a large extent, ignored.

The distinctive characteristics of the former system can be summarized as follows:



### 1. Personnel

The State made practically all the decisions regarding the number of employees assigned to an enterprise, the employee wage scale, the hiring and firing criteria, and the personnel structure of the enterprise. In addition, many workers were engaged in non-productive activities such as CCP, trade union, and youth league activities. The wage scale was based on seniority and egalitarian principles which did not offer much incentive for hard work.

### 2. Finance

Capital contribution, loans, and investment funds were allocated by the State. All the profits of the enterprises had to be submitted to the State, which in turn absorbed all the losses.

### 3. Assets

Assets were assigned by the State to the enterprises. Only the State could sell, lease, or otherwise dispose of the assets.

### 4. Supplies

The State selected the suppliers and arranged for the supplies needed by the enterprises.

### 5. Production

The State determined the kind and quantity of products an enterprise should produce.

### 6. Sales

The State bought or arranged for the sale of an enterprise's products at prices fixed by the State.

With respect to the above factors of production, an enterprise could make very few independent decisions. Moreover, at each level of the enterprise's hierarchy, there was a CCP member who often influenced a manager's decision with non-economic, ideological considerations.

Under these circumstances, the workers and the managers of each enterprise had very little incentive to work hard. This lack of incentive resulted in a slow pace of overall economic development. Since the supply of all factors of production and the sale of products or services were planned, and the prices were fixed, there was little competition in the market. This caused the enterprises' productivity and the quality of goods and services provided to remain low. Because the State absorbed all profits and losses, inefficient enterprises were not eliminated by the process of natural selection in the

market place. Many enterprises were operated at a loss for an extended period of time.

#### IV. TWO REFORM PROPOSALS

Two major proposals have been made by economists to reform this inflexible state-planned enterprise system: the stock ownership system (*gufenzhi*),<sup>6</sup> and the separation of enterprise management from state ownership (*jingyingquan yu suoyouquan fenli*).<sup>7</sup> The stock ownership system is based on the Marxist principle of property ownership by the people. Under this theory, state ownership of enterprises is transferred to individuals who will work in, and at the same time, own the stock of the enterprises. Because these individuals, as owners, are responsible for the profits and losses of the enterprises, they will have the incentive to work hard and engineer the growth of the enterprises and, ultimately, the economy.

The theory of separating enterprise management from state ownership is based on the Western economic principles behind publicly held for-profit corporations. In these Western companies, stock ownership is held by the shareholders while the management responsibilities are delegated to the companies' officers. Under this second theory, the State, like the shareholders in the West, retains ownership of the enterprise. However, much of the management responsibility, which was previously exercised by the State, is transferred to the enterprise directors, who serve similar functions as the officers in the West. Because of the severance of the management relationship between the State and the enterprises, state plans will become less significant. Prices of a larger number of products and factors of production will be allowed to float freely, creating a market economy to guide the operation of enterprises. This more competitive environment will cause enterprises to be more productive, and to supply goods and services of a higher quality.

Under the stock ownership system, the ownership structure of enterprises is very similar to that of for-profit corporations in the West. This theory is often attacked as being too capitalistic. In contrast, under the separation theory, the State retains the ownership of the enterprises, which are in substance a cross between the former state-controlled enterprises and the Western for-profit corporations. This compromise approach, which is more acceptable to

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6. See Jin & Zhang, *Zichan jingying zerenzhi he gufenzhi de bijiao* [A Comparison between the Capitalist Management Responsibility System and the Stock Ownership System] JINGJI YANJIU [ECON. RESEARCH], no. 5, May 1987, at 40 (giving a detailed analysis of the stock ownership system).

7. See Ding, *Jingying quan yu suoyou quan* [Management Right and Ownership Right] FAXUE YANJIU [STUD. L.] Jan. 1987, at 12 (providing a detailed analysis of the separation of enterprise management from state ownership).

PRC leaders, has been adopted by the newly approved Enterprise Law.

## V. THE ENTERPRISE LAW

### 1. Basic Principles

The New Enterprise Law is applicable to virtually all state-owned enterprises,<sup>8</sup> including enterprises leased or contracted out for operation.<sup>9</sup> It is based upon the principle of the separation of enterprise management from state ownership.<sup>10</sup> The State owns the property of an enterprise, but the enterprise has the right and the duty to manage the property.<sup>11</sup>

### 2. The Effect on Enterprises

The new Enterprise Law will probably increase the enterprises' efficiency and create a more competitive environment, resulting in the provision of goods and services of a higher quality. The law defines the enterprises' civil liability, outlines relevant procedures for various changes to the enterprises, and allows enterprises to have more direct contacts with foreign parties.

#### a. Increased Efficiency

As a result of the severance of the management link between the State and an enterprise, each enterprise is restructured as an independent accounting unit responsible for its own profits and losses.<sup>12</sup> It can even be declared bankrupt.<sup>13</sup> The enterprise's ultimate responsibility for its own profits and losses will cause its director to be more concerned about efficiency. This responsibility, together with the possibility that an enterprise may be declared bankrupt, should increase the efficiency and the productivity of enterprises in general.

#### b. Freedom in Production

The mandatory plan imposed upon an enterprise is more flexible than before, and the enterprise has much more freedom in carry-

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8. Enterprise Law art. 65.

9. *Id.* art. 66.

10. *Id.* art. 2.

11. *Id.*

12. *Id.*

13. *Id.* art. 19(3). Article 43 of the Law of the People's Republic of China on Enterprise Bankruptcy (Trial Implementation), adopted Dec. 2, 1986, China Ls. for Foreign Bus. (CCH Austl.) ¶ 13-522 provides that it shall be implemented on a trial basis on the day the Enterprise Law has been implemented for three full months. The Enterprise Law took effect on August 1, 1988 pursuant to its Article 69, and so the Bankruptcy Law became effective on November 1, 1988.

ing out its production activities. The enterprise has the right to request an adjustment of the plan regarding the supply of materials and the arrangement of product sales.<sup>14</sup> It may select the suppliers of raw materials,<sup>15</sup> and fix the prices of products and services not regulated by the State.<sup>16</sup> The enterprise even has the right to sell goods independently if they are produced in excess of the planned quota or are retained by the enterprise as its share under the plan.<sup>17</sup> The enterprise may freely lease or sell its fixed assets, which the State has authorized it to operate and manage, but the proceeds from the sale or leasing of assets must be used to replace obsolete equipment or to develop technology.<sup>18</sup> After covering the cost of production and taxes to the State, the enterprise may use its own remaining funds as it sees fit, pursuant to State Council regulations.<sup>19</sup> The enterprise may adopt its own compensation and personnel systems, and it may recruit and dismiss its workers.<sup>20</sup>

The flexibility of the mandatory plan, the enterprise's increased freedom in its production activities, and the enterprise's ability to fix the prices of those products and services not controlled by the State will create a partial market economy. Competition will increase, thereby forcing enterprises to become more efficient and to improve the quality of their goods and services. However, the extent of these improvements depends on the size of the market economy; the freer the market, the more pronounced the improvements will be.

### c. Civil Liability

The enterprise is subject to civil liability,<sup>21</sup> including products liability and liability based on quality warranty,<sup>22</sup> but its liability is limited to the extent of its property.<sup>23</sup> The Enterprise Law contains only two brief articles (Articles 38 & 60) on products liability and quality warranty and provides very little guidance for litigation under these legal principles. In order to develop these two complicated areas of law fully, more statutes and regulations must be promulgated, or case law must be allowed to develop through the court system. If Articles 38 and 60 cause the number of products liability and warranty claims against enterprises to increase, the

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14. Enterprise Law art. 23.

15. *Id.* art. 25.

16. *Id.* art. 26.

17. *Id.* art. 24.

18. *Id.* art. 29.

19. An enterprise may use its "retained funds" which equal its net income after deducting the cost of production and taxes. *Id.* art. 28

20. *Id.* arts. 30-32.

21. *Id.* art. 2.

22. *Id.* arts. 38, 60.

23. *Id.* art. 2.

currently underdeveloped liability insurance industry in China must be quickly built up to prevent enterprises from being forced into bankruptcy by massive claims.

#### d. Related Procedures

The law briefly outlines the procedures for the establishment, merger, division, and dissolution of enterprises, the issuance of bonds by enterprises, and the establishment of stock enterprises. An enterprise must apply to its supervisory government department and register for a business license. Upon registration, the enterprise may engage in activities within the registered scope of its business.<sup>24</sup> Mergers and divisions of enterprises must be approved by the supervisory government departments.<sup>25</sup> An enterprise will be dissolved if it is ordered to close for violation of law, if the supervisory government department orders it to close, if it is declared bankrupt, or because of other unspecified reasons.<sup>26</sup> The enterprise may invest in or hold shares of other enterprises,<sup>27</sup> and may issue bonds.<sup>28</sup> Article 66 of the law mentions stock enterprises (similar to Western-style privately owned for-profit corporations), implying that they are allowed to be established.

Supervisory government departments have detailed regulations on enterprises' registration for business licenses. However, with regard to the merger, division or dissolution of enterprises, Article 20 of the law simply states that, in such situations, enterprises shall settle their claims and debts according to law. There are no statutes or regulations specifically discussing the settlement of claims and debts. Mergers and divisions are complicated transactions. Detailed statutes and regulations are required to deal with legal issues such as the following: the rights and liabilities of the disappearing, surviving, and new enterprises; the changes or the preservation of the relationship between debtors and enterprises and between creditors and enterprises; and the status of legal actions and proceedings initiated by or against enterprises before or after mergers and divisions. The dissolution of enterprises is also a complex area, requiring provisions on legal issues such as the distribution of assets, the payment of debts and liabilities, and the status of legal actions and proceedings. The lack of regulations and statutes to deal with this multitude of issues could prove to be problematic.

Moreover, statutes and regulations on the issuance of stock and bonds by enterprises are scarce. Currently, there are several

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24. *Id.* art. 16.

25. *Id.* art. 18.

26. *Id.* art. 19.

27. *Id.* art. 34.

28. *Id.*

sets of municipal regulations,<sup>29</sup> as well as national notices,<sup>30</sup> that deal with the issuance of stock and bonds by enterprises. However, because the PRC securities market is at a pioneering stage of development, these provisions are inadequate. They fail to deal with significant legal issues such as the liability for misrepresentations in connection with the issuance and transfer of securities, the requirement for enterprises to file periodic financial reports to minimize misrepresentations, the prevention of unjustified profiteering by enterprise insiders, and the regulation of the parties involved in the sale of securities, such as stock exchanges, brokers, and agents.

Detailed statutes and regulations should be further developed to cover the legal issues related to the various procedures involving enterprises which are unaddressed in the Enterprise Law.

#### e. Relationships with Foreign Parties

Under the new law, an enterprise has the right to use its foreign exchange income, and to negotiate and sign contracts with foreign parties in accordance with State Council regulations.<sup>31</sup> These transactions with foreign companies include equity joint ventures, co-operative joint ventures, compensation trade transactions, technology transfer transactions, and import and export activities.

These new provisions do not allow enterprises to circumvent the general requirement of state approval for transactions with foreign parties. Relevant statutes and regulations still require these transactions to be approved by the appropriate government authorities. For example, Article 3 of the Law of the People's Republic of China on Sino-Foreign Joint Equity Ventures requires that contracts between parties to an equity joint venture be approved by the Foreign Investment Commission of the PRC;<sup>32</sup> Article 5 of the Law of the People's Republic of China on Sino-Foreign Co-Operative Enterprises requires that agreements between parties to a cooperative joint venture be approved by the State Council department in charge of foreign economic relations and trade.<sup>33</sup>

The real advantage of these provisions is that all enterprises which have their own foreign exchange can now conclude transac-

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29. *See, e.g.*, Interim Procedures of Guangdong Province for the Administration of Stocks and Bonds, adopted Oct. 10, 1986, *reprinted in* E. ASIAN EXECUTIVE REP., May 15, 1987, at 22.

30. *See* Zheng, *Securities Regulation in China: Development and Conflicts*, E. ASIAN EXECUTIVE REP., May 15, 1987, at 7 (providing a brief description of the State Council's March 27, 1987 notice on the administration of securities and interim regulations governing the issuance of bonds for state enterprises).

31. Enterprise Law art. 27.

32. Adopted July 1, 1988, promulgated July 8, 1979, China Ls. for Foreign Bus. (CCH Austl.) ¶ 6-500.

33. Adopted Apr. 13, 1988, China Ls. for Foreign Bus. (CCH Austl.) ¶ 6-100.

tions directly with foreign companies. It is no longer necessary to go through specialized enterprises which were exclusively authorized by the State to carry out transactions with foreign parties.

Import and export transactions, however, must still be handled by specially authorized enterprises. Enterprises' import and export activities are specifically governed by the Interim Regulations on the Import Commodities Licensing System of the People's Republic of China (the "Import Regulations"),<sup>34</sup> and the Provisional Regulations Governing Export License System of the Administrative Commission on Import and Export and the Ministry of Foreign Trade (the "Export Regulations"),<sup>35</sup> respectively. Article 4 of the Import Regulations and Article 2 of the Export Regulations provide that, without government approval, enterprises other than import and export enterprises with specific State authorization are prohibited from importing or exporting products.

Thus, the new provisions allow all enterprises which have foreign exchange to directly enter into transactions with foreign parties without the necessity of going through intermediary foreign trade enterprises. The one exception is import and export activity which still must be handled by special enterprises.

### 3. Enterprise Directors

The Enterprise Law gives more power to enterprise directors, but it stipulates certain restrictions to balance such increased power. It eliminates a part, though not all, of the problems which directors faced under the State-planned enterprise system. Also, the Enterprise Law only touches upon the tort law area applicable to enterprise directors without developing it in greater detail.

In order to increase the enterprise directors' motivation to expand their enterprises and, ultimately, the state enterprise sector in general, the new Enterprise Law gives more power and incentives to the directors. An enterprise director has the power to draft plans for the enterprise subject to the approval of the workers and of various government departments;<sup>36</sup> to establish the administrative structure of the enterprise;<sup>37</sup> to appoint, remove, reward or punish deputy-director level cadres with government approval;<sup>38</sup> to appoint or remove middle-level cadres;<sup>39</sup> to motivate workers by rewarding and penalizing them;<sup>40</sup> and to make decisions on important issues with the help of an administrative committee of which he is the

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34. Promulgated Jan. 10, 1984, China Ls. for Foreign Bus. (CCH Austl.) ¶ 51-600.

35. Promulgated May 1980, China Ls. for Foreign Bus. (CCH Austl.) ¶ 51-500.

36. Enterprise Law arts. 45(1), 45(5).

37. *Id.* art. 45(2).

38. *Id.* arts. 45(3), 45(6).

39. *Id.* art. 45(4).

40. *Id.* art. 44(6).

chairman.<sup>41</sup> In addition, the supervisory government department shall reward an enterprise director for his outstanding achievements in managing the enterprise.<sup>42</sup>

The law carefully balances the increased power of, and incentive for, the enterprise director with administrative and legal restrictions. The enterprise director is appointed and dismissed by either the supervisory government department, after considering the views of the Representative Assembly of Workers ("Representative Assembly"), or by the Representative Assembly with government approval.<sup>43</sup> Government approval is also required for many of the decisions made by the director discussed in the previous paragraph. If an enterprise director's negligence in his performance of official duties causes serious damage to the enterprise, the State, or individuals, he will be investigated for administrative, as well as for criminal liability.<sup>44</sup> Enterprise directors will also be investigated for administrative penalty and criminal liability for their abuse of power for private gain, or for the violation of the workers' interests.<sup>45</sup>

There were basically two problems for enterprise directors under the former state-planned enterprise system. First, because of egalitarian principles, enterprise directors' pay was often as low as that of the workers, and, even in profitable years, they collected a minimal bonus. Second, their freedom in managing the enterprises was often hampered by "mothers-in-law," such as party cadres within the enterprises, and government officials of supervisory departments.

The new law does not go far enough in eliminating these problems. It is true that supervisory government departments will reward factory directors for outstanding achievements. However, the law falls short of specifying that enterprise directors are entitled to a higher salary or that they have the power to award themselves bonuses. Without such specific provisions, enterprise directors may be hard pressed by the dominant egalitarian culture to forego these monetary incentives. Though the new law transfers more power to enterprise directors, many of their decisions must still be approved by "mothers-in-law," such as the workers through the Representative Assembly, or by supervisory government departments.

The new law touches upon the enterprise directors' liability in their negligence in the performance of official duties. This area of law, which is a part of torts under the Common Law system, is too

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41. See *id.* art. 47 for the make-up of the administrative committee and the definition of "important issues."

42. *Id.* art. 48.

43. *Id.* art. 44.

44. *Id.* art. 63.

45. *Id.* art. 62.



complex to be treated in just one brief article (Article 63) in the Enterprise Law. Similar to the products liability and warranty laws which were discussed in Section 2(c) above, this area of law must be further developed.

#### 4. Supervisory Government Departments

Not only does the new law reduce the power of supervisory government departments, it also creates more restrictions upon their exercise of such power. A supervisory government department issues directive plans to its subordinate enterprises.<sup>46</sup> It also provides guidance and consultation services to the enterprises to help them in the formulation of policies.<sup>47</sup> It can even order them to dissolve.<sup>48</sup> A supervisory government department also has the authority to approve major capital construction and technical transformation plans submitted by enterprises.<sup>49</sup> It has the power to approve actions taken by enterprise directors as discussed in Section 3 above, and to appoint, remove, award, and penalize enterprise directors.<sup>50</sup> Supervisory government departments may also coordinate relations between the enterprises and other units.<sup>51</sup>

Under the new law, supervisory government departments may not encroach upon the property rights of enterprises,<sup>52</sup> encroach upon the independent management rights of enterprises,<sup>53</sup> arbitrarily divert factors of production from one enterprise to another,<sup>54</sup> or arbitrarily fix the number of workers assigned to an enterprise.<sup>55</sup> Enterprises are given the right to appeal supervisory government departments' decisions under the last three of the subsections described above to higher administrative bodies.<sup>56</sup> To further limit supervisory government departments' power, an enterprise is allowed to reject a government department's production assignments outside the mandatory plan<sup>57</sup> and reject government departments' arbitrary diversion of the enterprise's factors of production.<sup>58</sup> Finally, leading cadres of government departments whose negligence causes serious damage will be investigated for administrative or

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46. *Id.* art. 55.

47. *Id.* arts. 56(1)-(2).

48. *Id.* art. 19(2).

49. *Id.* art. 55.

50. *Id.* arts. 44, 48, 55.

51. *Id.* art. 56(3).

52. *Id.* arts. 14 & 56(4).

53. *Id.* art. 58.

54. *Id.*

55. *Id.*

56. *Id.* art. 61.

57. *Id.* art. 23.

58. *Id.* art. 33.

criminal liability, or both.<sup>59</sup>

As discussed under Section 3 above, the law does not go far enough in eliminating supervisory government departments as "mothers-in-law," who adversely affect the independent and efficient operation of enterprises. The new law touches upon government officials' liability for their negligence in the performance of official duties. This area of law, called sovereign immunity in common law, is too complex to be discussed in only one article (Article 63). Like the products liability and warranty laws, and the tort laws discussed in Sections 2(c) and 3 above, this field of law needs further examination and development.

## 5. Workers

Part of the power previously enjoyed by supervisory government departments is given to the workers in the enterprises. Through the Representative Assembly, the workers are given the power to evaluate the administrative leaders of an enterprise,<sup>60</sup> make suggestions regarding their rewards, penalties, appointment, and removal;<sup>61</sup> to elect and remove the enterprise director subject to the supervisory government department's approval<sup>62</sup> if election by workers is chosen as the method for selecting the director;<sup>63</sup> to discuss and decide on plans concerning workers;<sup>64</sup> and to discuss and offer suggestions on other enterprise plans.<sup>65</sup> Workers will be rewarded for their achievements at work.<sup>66</sup>

The sacrifice that the workers have to make is minor when compared to the new power and benefits that they will enjoy. Their egalitarian pay scale will be replaced by a new system of distribution according to productivity,<sup>67</sup> possibly causing pay cuts for some marginal workers. The new authority of enterprises to make personnel changes and establish their personnel structure<sup>68</sup> may cause some surplus personnel to lose their "iron rice bowls."

Under the former state-planned enterprise system, workers had very little say in the management of enterprises, but they were secure in their jobs. The new law will substitute incentives to work

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59. *Id.* art. 63.

60. *Id.* art. 52(4).

61. *Id.*

62. *Id.* arts. 44, 52(5).

63. The supervisory government department has the power to make this choice of the method for selecting the enterprise director. *Id.* art. 44.

64. *Id.* arts. 52(2)-(3).

65. *Id.* art. 52(1).

66. *Id.* art. 45(6).

67. *Id.* art. 13.

68. *Id.* arts. 31-32.

hard for this security, and give more management power to the workers, thus creating a new group of "mothers-in-law."

## 6. The Chinese Communist Party

The law is ominously quiet about the CCP's role in an enterprise. The law simply provides that the CCP shall guarantee and supervise the enterprise's implementation of both the State's and the CCP's principles and policies.<sup>69</sup> Only one article out of the sixty-nine articles of the Enterprise Law is devoted to defining the rights and obligations of the CCP. It is possible that any reduction in the CCP's influence is so controversial that the law drafters decided not to deal with it at all. One can expect the CCP to continue its role as a "mother-in-law," wielding an irrationally large amount of power in the management of enterprises.

## VI. CONCLUSION

After eight years of deliberation, the Enterprise Law was finally passed by the NPC. Its long legislative history demonstrates that CCP policies are very important in the PRC legislative process, that whether a law will produce positive results in practice is a key to the adoption of a law, and that the PRC is increasingly democratic in its law making process.

The Enterprise Law was adopted as an attempt to completely reorganize the former state-planned enterprise system. Under the previous system, enterprises were tightly controlled by "mothers-in-law," such as the State, through directive plans, from without, and by CCP members from within. Because every aspect of production was planned, staff, workers, and managers had little incentive to work hard. Without incentives to work hard, economic development was slow. Fixed prices resulted in a lack of competition, and caused product and service quality to remain low. The State was responsible for all profits and losses, leading to the inefficient operation of enterprises.

The new Enterprise Law makes each enterprise responsible for its own profits and losses and allows an enterprise to go bankrupt. Efficiency and productivity will be enhanced. A partial market system, in which the directive plan occupies a less significant role, is being ushered in. The increasing importance of prices will stimulate competition among enterprises, eventually resulting in an improvement in the quality of goods and services. The new law offers enterprise directors, managers, and workers more incentive to work hard. It gives them more management power, provides them with awards for outstanding achievements, and requires that staff and

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69. *Id.* art. 8.

workers be paid according to productivity rather than egalitarian principles.

Unfortunately, the new law does not go far enough. The new economic system is only a partial market system with some prices still fixed. The new law also fails to specify that enterprise directors are entitled to a higher salary and to bonuses for outstanding performance. The law does not completely eliminate the adverse influence of "mothers-in-law." Supervisory government departments still retain much of their planning and approval power. The law is silent on the restriction of the CCP's power, and will probably only minimally reduce such power. It also creates new "mothers-in-law" in the workers.

The new law treats complex areas of law such as products liability, warranty, enterprise mergers, divisions and dissolutions, securities, tort, and sovereign immunity too briefly. Further development in these areas of law in the form of statute and regulation promulgation or case law development is needed.