INTRODUCTION

The assumptions behind the past ten years of economic and legal reform in the People's Republic of China ("PRC") have been rooted in the belief that creation of a legal regulatory mechanism can engender the very institution which the law has been created to regulate. Although this may sound like a logical conundrum, Chinese experience has recently confirmed it. For example, the 1979 Sino-Foreign Joint Venture Law\(^1\) encouraged the creation of limited liability equity joint ventures between Chinese and foreign participants where no such entities had existed before the law's promulgation. Indeed, no company law of general applicability has ever been put forward by the PRC Government, and only in the past few years have some of the implications of the term "limited liability" been explicated by the newly announced General Principles of Civil Law.\(^2\)

In general, this experience controverts the usual relationship between economic and legal change. Over the course of history, legal regulation has necessarily lagged behind developments in the economic sphere, imposed when the appearance of or the evolution of certain phenomena has created a need for it.\(^3\) Much more rarely have legal rules been drafted with a view to creating wholly new economic institutions which presumably would not otherwise arise. The problems in the PRC which both engender and explain this seeming paradox are that the demands of its statist political order will not allow any new actor to emerge in the economy without explicit authorization from the state, which only legislation can provide; and, conversely, certain components of a modern economy require the support of a regulatory framework to function properly, making the existence of such regulation a

\(^1\) Zhonghua renmin gongheguo zhongwaihezijingyingqiye fa [Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment], promulgated on and effective from July 8, 1979, translated in 1 CHINA L. FOREIGN BUS. ¶ 6-500, at 7,801 (CCH Australia Ltd. ed. 1985) [hereinafter Joint Venture Law].


\(^3\) See, e.g., White, Where Do Markets Come From?, 87 AM. J. SOC. 517 (1981) (for the social background to market formation); see also Joffe, Law and Economy in the USSR, 95 HARV. L. REV. 1591 (1982) (for a perspective on the socialist economy).
necessary but not a sufficient condition for their development. Thus, it would appear that the lack of legal regulation impedes the spontaneous generation of new economic phenomena, while at the same time the non-existence of various economic activities renders law for their regulation supererogatory.

The practical problem, I suggest, for the Chinese government leader is: Shall he await manifestations of economic behavior which require legislative control before legislatting, or shall he attempt to legislate new economic arrangements into existence? Although the first sequence of events fits the historical model better, the present Chinese political order renders it rather futile. The second sequence better comports with political realities, but is it a feasible way to proceed economically? In the specific examples which are examined below, recent legislative enactments will be examined to determine how well Chinese law has succeeded in inducing change in the economy.

II

Due to the undeveloped and rapidly evolving nature of Chinese financial markets and the laws and regulations which govern them, it is probably premature to address the topic at this time. Students of the Chinese legal system outside of the PRC since 1949 have, however, learned to extrapolate from limited data about certain social phenomena; the risks of such an enterprise are obvious, and often we have miscalculated grossly. Nonetheless, the recent emergence of the PRC from its self-imposed isolation, the quantity of information about Chinese society which has become available to scholars outside of China over the past ten years, and the general direction of policy pronouncements at the highest levels of Communist Party and state leadership have emboldened commentators on the current scene to speak with greater assurance.

The area of financial regulation falls within this paradigm; much information—legal and otherwise—has recently become available about it, and the development intended for Chinese financial markets by the PRC leadership has become increasingly apparent. While the final contours of the emerging Chinese financial system remain unclear, significant features have begun to appear. This paper will focus on two of these features—reform of the banking system and creation of securities markets—as well as on the discrete regulations affecting them as a means of examining the relationship between legal regulation and economic development in the PRC. Beyond the mere description of the specific regulations examined, this inquiry will attempt to adduce some general points for analysis of the parallel reform of

China's legal and economic systems in pursuance of the general goals of the current PRC modernization program. Although it is somewhat beyond the scope of this paper, the range of legal and non-legal considerations which promote wider reliance on market forces will be considered insofar as they relate to regulation of financial markets.

For both foreign and Chinese observers of the various changes which have taken place in China over the years since the Third Plenum of the Eleventh Communist Party Congress in December 1978, one of the most interesting developments has been the emergence of financial markets. Despite the fact that these have yet to achieve the range and sophistication of the long-established markets of more economically developed countries, the very fact of their existence is remarkable to some; others more familiar with China's recent development are impressed with the extent of their evolution from rather inauspicious beginnings in the late 1970's. In parallel with the appearance of these economic activities, legislative enactments have appeared to encourage and to facilitate, as well as to regulate, these emerging markets.

The necessity for capital markets became abundantly clear to leading figures in Chinese economic circles shortly after the momentous changes began in the late 1970's to open China to the outside and to reinvigorate China's then-stagnant domestic economy. Rather than follow the former policy of channeling all investment decisions through the state planning process, merely earmarking funds for enterprises to be dispensed through the People's Bank of China, it was recommended that various activities to raise funds from society—at all levels, from both units and individuals—should be not only permitted but also encouraged. Moreover, as economic reforms

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10. See Chu, supra note 5, at 374 (concluding that banking and financial transactions with China have become increasingly sophisticated in recent years and that they should become somewhat easier to conclude as China develops its legal system and gains experience in international finance).
13. See, e.g., Yu, supra note 4:
We should not only improve and develop a commodity market, but also open up a financial market accordingly. We know that the primary goal of the monetary policy of the central bank is to regulate and control the macroeconomy so as to tighten control without sacrificing invigoration of the economy. Therefore, we must promote the important banking intermediaries and must also set up other financial intermediaries for gradually creating prerequisites adapted to the needs for financing economic development.
began to show some success, particularly in the rural agricultural sector, the supply of and demand for funds both mushroomed.  

A greater share of decisionmaking authority about funding devolved in the early 1980's to lower level units and local governments, but at the same time there were fears that unregulated fundraising activity might hinder the flow of funds to the most productive investments and also result in occasional losses to investors. At both the national and local government levels, there were concerns about controlling the issuance of shares and bonds by enterprises and other units which produced a certain amount of legal regulation.

Significantly, while these economic developments were occurring all over China, an important debate was being pursued among the Chinese leadership about the basic nature of ownership in Chinese society and about the advisability of encouraging shareholding and other forms of private or quasi-private ownership of the means of production in a socialist country. Notwithstanding a tiny, but vocal, minority who opposed any form of such ownership in China, the debate in large part engaged two bigger factions which only disputed the extent to which such forms of ownership should be encouraged. At the present time, it appears that a limited amount of share- and bond-holding will be permitted but that there is still no agreement as to the percentage of an enterprise's value which might be opened to "public" ownership.

[After interim regulations of the People's Bank of China permitting interbank loans were promulgated in 1986,] [non-bank credit institutions also began to participate in the interbank loan market. The rural and urban credit cooperatives generally join the banks' market of the same city, while the trust and investment corporations with operations covering broader territories may grant loans to or be granted loans from parties in other cities or provinces. In 1986 an interbank urban loan market of 16 urban credit cooperatives was established in Wuhan.


15. Su, Stock Market Talk Along the Bund, China Daily, Mar. 9, 1985, at 4; Note, Shareholding: Possibilities, BEIJING REV., No. 19, May 12, 1986, at 22. See also Brevetti, Shanghai Stock Exchange Share Fully Subscribed, South China Morning Post, Oct. 30, 1986, at 1 (1400 local companies have issued stock, but only two had already received approval from the People's Bank of China to sell on the Shanghai Exchange).


19. Note, supra note 15:
two important figures, Zhou Jiayuan, Deputy Director of the Shanghai branch of the Bank of China, and Xie Zongqiang, Assistant General Manager of the Shanghai Investment and Trust Corporation, agreed that it would be difficult to reopen a stock exchange in Shanghai and that “there won’t be any market of this kind within three or four years.” Among the problems they raised were the need for a legal framework for securities trading and enterprise bankruptcy, as well as limitations to prevent speculation.

The subsequent opening of markets in Shanghai, as well as in Shenyang, Wuhan, and elsewhere in China (the New York Times believes Beijing, Tianjin, and Harbin as well), has proven Zhou and Xie partially wrong in their predictions. Nevertheless, it is important to note that the newly opened “stock exchanges” are not full-fledged markets by any definition. The number of issues traded is small; in many cases, most of the trading is in bonds and not shares. Moreover, in an article published in March 1987, the official People’s Daily stated that trading shares would “not [be] compatible with socialist materialist civilization,” since shareholders would think only of the economic advantage of their own companies, rather than of the nation as a whole.

One of the first bond-trading centers to open in China, in the northeastern industrial city of Shenyang, proposed at the outset a set of simple rules which would provide the rudiments of transferability and liquidity along with safeguards against speculation and other sharp practices. Bondholders were to be allowed to trade bonds, an important concession since many early issues of both shares and bonds contained restrictions on their transfer.

Given these problems in introducing shareholding in China, the state should hold the greatest number of shares. Legally, the state is entitled to own the major share of the means of production. The state shareholders, through their representatives on the boards of directors, participate in the decision-making of the enterprises so as to protect the interests of the state as property proprietors and also ensure that the state does not interfere in the day-to-day management of the enterprises.

20. Su, supra note 15. Both Xie and Zhou point out that presently [sic] there is only a limited number of qualified shares and stocks and public stock trading is hardly possible. “But once stocks increase in number, things might change,” they admitted.

21. Id.

22. Id. It should be noted that a bankruptcy law has been promulgated in China since the date of this article and has gone into force following the enactment of “The Law Concerning State Enterprises Owned by the Whole People of the People’s Republic of China” (adopted Apr. 13, 1988) (effective Aug. 1, 1988) (promulgated by the First Session of the Seventh National People’s Congress). See The Enterprise Bankruptcy Law of the People’s Republic of China (adopted on Dec. 2, 1986) (effective Nov. 1, 1988), translated in 19 Vand. J. Transnat’l L. 733 (1986).


24. Id. The markets, which mostly trade bonds, have yet to handle company shares along the lines of stock exchanges in the West. This impression was reinforced by the promulgation of interim regulations on bonds, but no comparable enactment with respect to shares, in March 1987. See Interim Regulations on the Administration of Enterprise Bonds (promulgated by the State Council on Mar. 27, 1987) [hereinafter Interim Regulations], translated in China Daily Bus. Weekly, Apr. 22, 1987, at 3.

25. See Wu, supra note 18.


27. Id.
Trading, however, would have to be done through the auspices of the Shenyang Trust and Investment Company. Interest rates on bond issues were also subject to a ceiling of 20 percent above the rates for fixed bank deposits with the same maturity. In Shanghai and other financial markets, monitoring of the issuance of shares by the very first enterprises allowed to sell shares on the new exchanges was effected through the People’s Bank of China, by using the powers of the Industrial and Commercial Bank to supervise the management and financing of industrial and commercial enterprises.

Since they did not similarly entail thorny questions about ownership, the reforms of the Chinese banking system to replace appropriations for all enterprises and construction projects included in the state plan with bank loans met with far less resistance. Nonetheless, production units accustomed to “eating from the big pot” by receiving annual appropriations regardless of their productivity or sales success were reported to be reluctant to adjust to the new system. Measures had to be adopted to compel the switchover and to reassure the hesitant about the terms for loan repayments.

Nor have the changes in China’s banking system been any less dramatic than the reforms which gave rise to the fledgling stock markets. The separation of the monolithic People’s Bank of China into several components, including a truly supervisory central bank as well as specialized operating banks, caused some controversy. Even more surprising was the recent re-establishment of the Bank of Communications as a joint-stock institution, perhaps clearing the way for more financial institutions outside the close

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28. *Id.* Shenyang Trust and Investment Company is supervised by the Shenyang branch of the People’s Bank of China, so the virtual monopoly of the central Chinese bank over financial transactions would be maintained under such an arrangement.

29. *Id.* A further feature peculiar to the Shenyang market was that many of them carried cash prizes, awarded in a lottery fashion, which about 10% of the bondholders received. Top prize for a bond with face value of 50 yuan was originally to be 20,000 yuan but was later lowered to 8000 yuan and then to 5000 yuan to forestall criticism that bond purchases were nothing more than legalized gambling.

The Interim Regulations, supra note 24, eventually set the maximum interest for state enterprise bonds at 40% of the interest rate for individual time savings accounts at the time of issuance of the bonds. Interim Regulations, art. 18.


33. Shen, *Banking to Rebuild Lost Glory*, China Daily Shanghai Focus, Mar. 27, 1989, at 3 (80-year-old Bank of Communications is China’s first shareholding commercial bank with a wider scope of business, including real estate and insurance, than that of state banks).
control of the state banking apparatus. At the same time, new financial instruments have appeared, often in advance of the legislation authorizing their issuance and delineating their terms.\textsuperscript{34} In addition to shares, commercial paper, state treasury bonds, and enterprise bonds have all been publicly offered for sale over the past few years in the PRC.\textsuperscript{35} Both rural and urban credit cooperatives have been revived and strengthened as the grassroots mainstay of China's banking system,\textsuperscript{36} and they provide most of the credit for the peasant entrepreneurs and individual enterprises who are creating the new socialist economy with Chinese characteristics.\textsuperscript{37} Finally, more than a hundred non-bank financial institutions\textsuperscript{38} have opened since 1979, among them national and regional trust and investment companies and leasing companies offering new avenues for creative financing.\textsuperscript{39}

The People's Bank of China, both as central bank and as the entity with the legal regulatory power over financial institutions, has nominally maintained control over these developments in finance. Yet as the number and complexity of institutions and instruments increases, it will likely become more difficult to keep track of them. Already the need for specialized knowledge and regulatory mechanisms is becoming clear.\textsuperscript{40} In the foreseeable future it may become necessary for the People's Bank of China to share some of its authority with the Ministry of Finance or to delegate it to new bodies, such as a Securities Commission or other entities with a narrower regulatory mandate and greater resources.

\textsuperscript{34} See, e.g., Administration of Enterprise Short-Term Financing Debentures: Tentative Procedures (promulgated by the People's Bank of China, Shanghai Municipality; announced on December 6, 1987), reported in I CHINA BANKING AND FIN., No. 1, Jan. 25, 1988, at 10 (requiring enterprises that wish to issue short-term commercial paper to obtain a license from the local Administration for Industry and Commerce); see also Text, Experts Propose Limit to Nonbanking Institutions, Beijing CEI Database in English, Aug. 12, 1988, transcribed in FBIS Daily Report: China, Aug. 15, 1988, at 40 (describing attempts to limit the proliferation of non-bank financial institutions outside the management and control of the central bank).

\textsuperscript{35} do Rosario, Borrowing Boom, FAR E. ECON. REV., Sept. 14, 1989, at 63 (growing sophistication and activity in financial markets, at least in Shanghai, even after economic retrenchment of late 1980's).

\textsuperscript{36} Xie, Bank Starts Network To Ease Funds' Flow, China Daily, Mar. 17, 1987, at 2 (national network of county branches and credit cooperatives handle the work of the Agricultural Bank of China); Shang, supra note 12 (rapid development of collective and individual businesses led to swift development of urban credit cooperatives in large- and medium-size cities).

\textsuperscript{37} Xie, supra note 36.

\textsuperscript{38} See, e.g., Comment, Corporate Financial Companies Plays [sic] Greater Economic Roles, 9 CHINA ECON. NEWS, No. 30, Aug. 8, 1988, at 1; see also Regulate Non-bank Institutions, China Daily, Dec. 10, 1988, at 4 (stating that China then had 1790 city credit cooperatives and 730 trust investment companies, enterprise financial companies, and leasing companies).

\textsuperscript{39} E.g., CITIC [China International Trust and Investment Corporation] Boosts Capital Base for Expansion, 8 CHINA ECON. NEWS, No. 48, Dec. 14, 1987, at 1 (bond issuance and borrowing totalled $800 million in 1987 for CITIC Industrial Bank, CITIC's banking arm); Dai, Banking Monopoly To Be Broken Up, China Daily, June 3, 1988, at 2 (development bank created in Guangdong Province by bank shareholders with Hong Kong funding to challenge monopoly of the Guangdong provincial branch of the People's Bank of China).

\textsuperscript{40} Shang, supra note 12, at 6 (noting need for improved macro-management by the central bank, including better management methods at every level and more economic and financial legislation, as well as better statistical and information networks).
During the past two or three years, there has been a flurry of legislative activity to create the framework for a system of financial market regulation in China. Of necessity, this inquiry can focus on only a few of them; I hope that those chosen will prove illustrative. In the area of securities regulation, the two sets of regulations under consideration are the Interim Regulations on the Administration of Enterprise Bonds—a set of nationwide rules promulgated by the State Council in March 1987—and the Xiamen Rules on the Management of Shares and Bonds—local rules approved by a provincial legislature for a single special economic zone. Both share certain features: encouragement of bond financing in preference to share issuance; limitations on the face values and interest rates of securities; and entrustment of administration and interpretation of the laws to the People's Bank of China.

The national Interim Regulations on the Administration of Enterprise Bonds ("Interim Regulations") spell out in some detail the requirements for issuance of bonds by state-owned enterprises. In thirty articles, divided into five main parts, the Interim Regulations set forth the current policy of directing state enterprises to raise funds with bonds and not to sell their shares to the public; one interesting provision, which prohibits compulsory purchases of bonds, suggests that certain enterprises may have been forcing employees and perhaps other related persons to buy bonds. The People's Bank of China is established as the administrative organ for the issuance of bonds; no bonds can be issued without its approval.

Under Part Two of the Interim Regulations, "enterprise bonds" are defined as negotiable securities issued by enterprises on the basis of legal procedures with fixed provisions for payment of interest and repayment of principal. The Interim Regulations list which terms are required to be stated on the face of the bonds and state that the People's Bank should

41. Interim Regulations, supra note 24.
42. Xiamen's Rules on Management of Shares and Bonds (effective Sept. 1, 1986), 7 CHINA ECON. NEWS, No. 43, Nov. 24, 1986 [hereinafter Xiamen Rules].
43. Interim Regulations, supra note 24, art. 29; Xiamen Rules, supra note 42, art. 27 (although the responsibility was vested in the Xiamen Branch of the People's Bank of China).
44. Interim Regulations, supra note 24, art. 8 (holders are entitled to payment of interest and repayment of principal but do not have the right to participate in management of the enterprise) and art. 9 (holders are not to be held responsible for the business of the enterprise). Also, in comparison to the Xiamen Rules, supra note 42, which expressly encompass both bonds and shares, the Interim Regulations are limited to bonds.
45. Interim Regulations, supra note 24, art. 3. The issuance for purchase of enterprise bonds should abide by the principles of voluntary participation, mutual benefit, and payment. Compulsory purchase of bonds is banned in enterprise bond issues.
46. Id. art. 4. Chapter Three, "Administration of Enterprise Bonds," explains in detail the process whereby the People's Bank of China approves the issuance of bonds.
47. Id. art. 5. "Negotiability" is nowhere defined in the Chinese legal lexicon, but some solace may be afforded the investor in bonds, at least, by the General Principles, supra note 2, art. 90: "A lawful loan relationship is protected by law."
48. Interim Regulations, supra note 24, art. 6 (including the enterprise name and address, the bond's face value and interest rate, maturity, means of payment of principal and interest, serial number, seal of the enterprise, and proof of approval by a proper administrative organ).
approve the form of such bonds. Several articles provide the basic features of Chinese bonds: bondholders have no voice in an enterprise's management; are not liable for the enterprise's business (nor, presumably, for its losses); and may transfer, mortgage, or bequeath their bonds.

The section of the Interim Regulations on administration provides that, within the framework of centralized administration of the economy, the People's Bank of China shall work out quotas for issuances of bonds on a national basis. Enterprises issuing bonds are required to "announce" certain matters, including facts about their management, use of funds raised, means of repayment of the bonds, and so on. Furthermore, enterprises applying to issue bonds must file various materials with the People's Bank of China, such as a business license, upper level approvals, and financial reports. Total value of the bond issue may not exceed the enterprise's net asset value; the interest rate on the bonds may not exceed 40 percent of the bank rate for individual savings at the time of issuance. An interesting provision allows enterprises to issue bonds themselves or to use an agent, who may charge a commission; these agents have no liability for the business of the enterprises which hire them. Only banks and other institutions authorized by the People's Bank of China may handle transfer, issuance, and other transactions involving bonds. The People's Bank is authorized to inspect and to examine the use of funds by enterprises which have issued bonds and by enterprises which have purchased bonds.

Legal responsibility for administering sanctions against those who violate the Interim Regulations rests with the People's Bank. These sanctions range from freezing the funds raised by the bond issue to a fine of 5 percent of the funds illegally raised. Individuals responsible for violations of the

49. Id. art. 7.
50. Id. art. 8.
51. Id. art. 9.
52. Id. art. 10.
54. Id. art. 14.
55. Id. art. 15. These materials may be filed with the People's Bank of China or with its branches. In addition to the items listed, art. 15, A-F, enterprises may also be requested to submit "other materials required by the People's Bank of China." Id. art. 15, G.
56. Id. art. 16. It should be noted that the Interim Regulations nowhere define such accounting terms as "net value of the assets of the enterprise."
57. Id. art. 18.
58. Id. art. 21. Enterprises can issue bonds by themselves or entrust banks or other financial institutions to issue bonds for them as agents. The agent institutions can charge a certain amount of commission on the basis of the total value of bonds they issue as agents. The agent institutions do not bear any responsibility for the business status of the enterprise which makes the entrustment.
59. Id. arts. 22 (banks and other specialized institutions approved by the People's Bank can handle transfer) and 23 (non-financial institutions and individual citizens cannot handle issuance and transfer).
60. Id. art. 24.
61. Id. art. 25 (with respect to violations of Interim Regulations, arts. 3, 4, 7, 11, 15, and 17).
62. Id. art. 25, A-D. The punishments of art. 25 may be implemented concurrently.
Interim Regulations may be subject to administrative disciplinary action as well as to economic penalties.\textsuperscript{63} Supplementary provisions of the Interim Regulations grant the right to interpret the Regulations to the People's Bank of China, along with the responsibility for drafting implementation regulations.\textsuperscript{64}

The Xiamen Rules on Management of Shares and Bonds ("Xiamen Rules") resemble the Interim Regulations in broad outline, although they apply to issuance of shares as well as of bonds.\textsuperscript{65} They present rules for the raising of funds for enterprises in the Xiamen Special Economic Zone, rules which apply to state-owned, collectively owned, and foreign-owned enterprises issuing stock or bonds in Xiamen.\textsuperscript{66} The characteristics of shares are detailed.\textsuperscript{67} Shareholders are allowed to participate in the enterprise's management, receive dividends, and bear liability for losses up to the value of their shares' capital.\textsuperscript{68} Small state-owned enterprises, along with other sorts of enterprises, are allowed to issue shares; by negative implication, larger state-owned enterprises most likely cannot.\textsuperscript{69} The value of shares issued shall not exceed the enterprise’s net asset worth,\textsuperscript{70} and shares are registered with perpetual duration, except for certain "fixed-term" shares.\textsuperscript{71}

Shares are classed as collective or individual, depending upon who buys them; the rights and benefits of shareholders are the same regardless of classification.\textsuperscript{72} Shares may either pay out dividends or pay dividends and interest.\textsuperscript{73} They can be sold, transferred, inherited, or used as security for loans.\textsuperscript{74} Upon dissolution or bankruptcy of an enterprise, shareholders

\textsuperscript{63} \textit{Id.} art. 28.
\textsuperscript{64} \textit{Id.} art. 29.
\textsuperscript{65} Xiamen Rules, \textit{supra} note 42, art. 2: State-owned, collectively-owned, domestic associated enterprises, as well as enterprises involving foreign investment (i.e., joint venture, cooperative, and wholly foreign-owned enterprises) desiring to raise capital through the issuance of shares and bonds shall be governed by the present regulations. (emphasis supplied)
\textsuperscript{66} Id.
\textsuperscript{67} \textit{Id.} Chapter Two, "Shares."
\textsuperscript{68} \textit{Id.} art. 3.
\textsuperscript{69} \textit{Id.} art. 4:
All small state-owned enterprises, urban and rural collectively owned enterprises, joint enterprises of various economic forms, and enterprises involving foreign investment which are economic entities enjoying the status of a legal person are allowed to issue shares for subscription by other enterprises, institutions, and individuals.
\textsuperscript{70} \textit{Id.} art. 5. Here the "net worth of existing assets" is defined as the "total value of fixed assets and circulating capital after deducting depreciation and borrowed capital."
\textsuperscript{71} \textit{Id.} Fixed-term shareholders are not allowed to participate in the management of the business operations of the enterprise but otherwise enjoy all the rights and benefits, and bear the same responsibilities, as do other shareholders under the provisions of the Xiamen Rules, art. 3. \textit{supra} note 68 and accompanying text.
\textsuperscript{72} \textit{Id.} art. 7:
Shares subscribed by enterprises and institutions are collective shares and those subscribed by individuals are individual shares.
\textsuperscript{73} \textit{Id.} art. 8.
\textsuperscript{74} \textit{Id.} art. 9.
receive distributions of the remaining assets (after paying taxes, wages, and debts) according to their proportion of share ownership.75

The provisions regarding bonds under the Xiamen Rules76 follow the national Interim Regulations but contain local standards for maximum interest rates.77 A special provision78 permits enterprises to sell bonds only to their staff and workers for certain purposes; such bonds may contain restrictions on their transfer.79 The Xiamen Rules also contain general rules about management, issuance, and purchase of shares and bonds.80 As with the Interim Regulations, the issuance must be supervised and approved by the People's Bank of China.81 Certain documents, including business licenses, higher level approvals, prospectuses describing use of funds, and financial statements must be submitted.82 Involuntary subscriptions are forbidden,83 and party cadres and military men are not permitted to purchase bonds or shares.84 The Xiamen Rules encourage the issuance of shares and bonds outside of the Xiamen Special Economic Zone, particularly in Taiwan, Hong Kong, and Macao.85

Agents, who may charge commissions, can be entrusted to handle the issuance of shares and bonds; as under the Interim Regulations, their liability

75.  Id. art. 10.  Note that the Xiamen Rules, art. 10, provide that "after the promulgation of the bankruptcy laws, matters on this regard will follow the new provisions." Hence, since November 1988, this article has been superseded by provisions of The Enterprise Bankruptcy Law of the People's Republic of China, supra note 22, art. 37:

After paying off the bankrupt expenses, the bankrupt estate will be liquidated in accordance with the following order:

(i) the employees' wages and the expenses of the labor insurance the bankrupt enterprise owes;
(ii) taxes the bankrupt enterprise owes;
(iii) bankrupt claims.

Where the bankrupt estate does not suffice to satisfy all the claims in the same order, the distributions will be pro rata.

76.  Id. Chapter Three, "Bonds."
77.  Id. art. 15 (30% plus interest at rates offered by banks for savings deposits for the same time limit).
78.  Id. art. 16.
79.  Id. (bonds may be transferable but transferees are restricted to staff and workers of the enterprise concerned).
80.  Id. Chapter Four, "Management, Issuance, and Purchasing of Shares and Bonds."
81.  Id. art. 17:

Public issuance of shares and bonds by enterprises is to be managed, examined, and approved by the Xiamen branch of the People's Bank of China.
82.  Id. art. 18.
83.  Id. art. 19.  Presumably this is meant to prevent enterprises from forcing employees, suppliers, and others to purchase their securities.
84.  Id. These prohibitions are in line with longstanding policies to preserve the ideological purity of Party and army members as well as to prevent improper entanglement by those who wield particular powers in economic decisionmaking.
85.  Id. art. 20:

Shares and bonds can be issued outside the Xiamen Special Economic Zone and to other areas of the country. Fellow countrymen in Taiwan, Hong Kong, and Macao, as well as overseas Chinese, may subscribe in accordance with the present Regulations shares and bonds publicly issued in the Xiamen Municipality.

Indeed, one of the unstated purposes of these rules seems to be to solicit funds for development within the Xiamen Special Economic Zone from Taiwan and Hong Kong compatriots as well as from other overseas Chinese.
for the business of the enterprise is limited. Unlike the Interim Regulations, the Xiamen Rules allow any unspecified financial agent to handle transfer and change of ownership of shares and bonds. Spot transactions are used to establish prices for securities under the Xiamen Rules. Interpretation remains the responsibility of the People’s Bank, although under the Xiamen Rules it is the Xiamen Branch of the People’s Bank of China which undertakes to interpret the rules.

IV

CONCLUDING REFLECTIONS

As can be seen, these two recent sets of rules can only begin to establish the framework for a complete system of financial regulation which may eventually emerge in the People’s Republic of China. Many difficult questions remain to be settled, among them the capacity of state-owned enterprises to issue shares and the practical effect of liquidity-limiting provisions regarding transfer of securities. In the area of banking law, the role of the specialized banks, the status and validity of new financial instruments, and the powers of the non-bank financial institutions all present new challenges for regulatory authorities.

In the long term, it is likely that both enterprises and investors may raise questions about the obvious conflict of interest arising by virtue of the

86. Id. art. 22.
87. Id. (referring only to “financial agents”); cf. Interim Regulations, supra note 24, art. 21, which refers to “banks or other financial institutions,” and art. 22, which requires approval from the People’s Bank of China for 16 specialized banks and other financial institutions to handle transfer transactions of enterprise bonds.
88. Id. art. 23.
89. Id. art. 26.
90. The Xiamen Rules, supra note 42, and parallel regulations issued in Guangdong Province, Interim Procedures of Guangdong Province for the Administration of Stocks and Bonds (adopted October 10, 1986, and effective from the date of promulgation), translated in Texts, People’s Republic of China—Section A, E. Asian Exec. Rep., May, 1987, at 22, suggest that stock ownership as well as bond purchase is encouraged by the economic reform faction in the People’s Republic of China. Yet the limitation of the Interim Regulations, supra note 24, strictly to bonds argues that the difficult problems a socialist regime confronts when stock is involved with questions of ownership have not been resolved.
91. Interim Regulations, supra note 24, arts. 22 and 23; Xiamen Rules, supra note 42, arts. 16 and 22.
92. See, e.g., Kristof, Chinese Bank Is an Anomaly, N.Y. Times, May 4, 1987, at D1:
   The state-run Bank of China, for example, is reportedly unhappy that Citic will open a commercial bank this month called the Citic Industrial Bank, which can deal in foreign exchange and will challenge the Bank of China on its own turf.
93. See, e.g., Beijing XINHUA in English, Bonds To Be Issued With Index-Linked Interest, monitored in FBIS Daily Report: China, June 27, 1989:
   Starting July 1, China will issue government bonds worth 12 billion yuan this year, with the interest rate pegged to the price rise index, according to a recent State Council circular.
94. See, e.g., Regulate Non-bank Institutions, China Daily, Dec. 10, 1988 (non-bank financial institutions have taken a great deal of funds from specialized banks and used circulating funds for fixed asset investment by paying higher than bank interest rates).
People's Bank of China's dual role. Not only does it control the banks which make loans to Chinese enterprises; it also controls those enterprises' access to other parts of the capital market. In part, this conflict may be inadvertent, a result of the newness of many sectors of the market and the paucity of trained personnel. Over the next several years, the direction taken by China's financial regulators should become more apparent. In addition, the power given to the People's Bank of China to interpret the very rules governing securities markets seems problematic, should serious disputes arise. Perhaps there will eventually appear, as in the United States and other countries with active financial markets, independent agencies with a special mandate for regulations and no particular interest in the process other than to uphold standards of honesty and fair dealing.

For the time being, it remains to be seen whether China's experiment in liberalizing its financial markets will have the desired results. Recent statistics suggest that China's financial markets are expanding rapidly, with widespread activity in a number of sectors. The long-term benefits of this change insure that these comments can serve only as an introduction to a field of legislation which will most certainly grow. It also awaits further developments to see whether China's unique forms of legal and economic engineering can, in fact, induce lasting changes.

In the light of current political developments in China, however, it may be appropriate to ask whether the necessary stability to assure rational economic actors about the predictability of outcomes and security of transactions exists in the PRC. The continued debate, in the contexts of both theory and practice, about the nature of ownership makes objective observers outside China skeptical that financial markets can weather political storms. As recently as January 1989, it seemed that ten years' study of questions of ownership and its relationship to economic reform had resulted in a breakthrough which would permit coexistence of various forms of ownership alongside state ownership. The shortcomings evident in state-owned enterprises had led a large number of economists and state government officials to believe that other forms of ownership would likely induce needed

95. As both central bank, with regulatory power over the financial markets, and as an operating bank controlling competing financial institutions. See, e.g., Shang, supra note 12.
97. Interim Regulations, supra note 24, art. 29; Xiamen Rules, supra note 42, art. 26.
98. The Securities and Exchange Commission, an independent agency of the federal government, is composed of five members appointed by the President with the advice and consent of the Senate. Not more than three Commissioners may be members of the same political party. The term of one Commissioner expires each year. Securities Exchange Act of 1934, Sec. 4, 15 U.S.C. § 78d.
99. Cf. United Kingdom (Bank of England oversight and self-regulation), Japan (independent agency modeled on United States Securities and Exchange Commission, with Ministry of Finance involvement), Hong Kong (newly created independent commission).
changes in the Chinese economy, strengthen the sense of responsibility of both managers and workers in Chinese enterprises for the operations of their units, and lead to considerable economic growth.\textsuperscript{102} Even Karl Marx was cited as authority for the proposition, applicable to the socialist economy, that "the shareholding system can turn the scattered private capital into social capital and can quickly gather a large amount of funds to do something that individual capital cannot accomplish."\textsuperscript{103}

Yet developments in three important aspects of the Chinese economy since the Tiananmen Massacre in June 1989 call into question the possibility that such reforms can continue on the same trajectory as before. Basic questions of ownership, the ongoing process of enterprise reform, and the particular institution of shareholding all appear to be threatened by a very marked change in the political atmosphere in China over the past half year. Unless there is a definitive re-assertion of the economic reform imperative which dominated in government and academic circles in recent years, all of the developments thus far may be overturned. For example, as to the nature of ownership in the PRC, recent articles suggest that "privatization" is now under attack. The argument is that unless socialist public ownership is upheld, privatization of ownership through recent reforms such as selling shares in public enterprises may lead to "undermining the root of socialism and turning socialism into capitalism."\textsuperscript{104} Indeed, the selling of shares in existing public enterprises has been labelled "tantamount to [mis]appropriating public property."\textsuperscript{105}

Such reversion to an earlier mode of economic analysis is one result of the new enforcement of political orthodoxy after the Tiananmen Massacre. Insofar as dangerous new ideas such as "privatization" and the new-found self-assurance of a financially independent group of small producers and entrepreneurs have been held to be responsible for the demonstrations which disrupted China during the spring of 1989, they are now being renounced as "capitalist" or "bourgeois." Only collectivized forms of ownership are now held to ensure the welfare of the broad masses of workers and to guarantee that they will not be exploited by a new class of "owners" who would be the sole group to profit from privatization.\textsuperscript{106}

Similarly, enterprise reforms begun during the 1980's which sought to give managers greater control of production decisions and worker efficiency, along with the arguments for reform which had stressed the backwardness of Chinese industry, are now both being downplayed. The new wisdom is that socialist public ownership has been strikingly successful in certain showcase industries and enterprises, at least as measured by net output value and

\begin{thebibliography}{9}
\item \textsuperscript{102} \textit{Id.}
\item \textsuperscript{103} \textit{Id.} at 49.
\item \textsuperscript{105} \textit{Id.}
\end{thebibliography}
Thus, the support which had been carefully built for significant change in the management of Chinese enterprises has collapsed. Continuing to urge such reform is now, in itself, indication of wayward tendencies which will not be tolerated in the aftermath of Tiananmen.

There are obvious and ominous implications for shareholding in this hardening of attitudes about the correct "line" on economic issues such as ownership and enterprise reform. First of all, it is possible that the whole process of selling partial ownership interests in Chinese enterprises will cease. At the very least, the limited experiments which have thus far been pursued may be further restricted to a tiny handful of the least attractive, economically most insignificant entities, in order to stress the primacy of orthodox state ownership and the marginal status of other forms of ownership. Second, the whole attitude of the populace about stock and bond ownership is being altered by the financial exigencies which China is now enduring, in no small part because of economic losses engendered by the events of last spring. One very telling report maintains that the Chinese Government is now forcing workers to accept up to 25 percent of their wages in the form of government bonds, which essentially constitutes forced borrowing necessitated by a serious cash shortage in China. Needless to say, the enthusiasm of such workers for other such investments will be seriously dampened by these tactics.

Finally, there is a new riskiness to the very act of owning shares in a rapidly changing political climate where yesterday's glorious entrepreneurs may become tomorrow's capitalist exploiters. It is by no means certain that those who merely followed the government's encouragement to participate in the restructuring of China's economy a few years ago will be protected from attack once those experiments fall into disfavor. Those who have not already purchased shares or bonds are unlikely now to do so; many who dabbled in the nascent markets may think it wise to unload their securities, should the opportunity arise, before they are caught by more violent shifts in China's political winds.

This has not discouraged die-hard economic reformers from continuing to promote the issuance of stocks and bonds as part of overall financial reforms in China. One recent article maintains that even in an economy where public ownership remains the "mainstay," there is a place for security-holding. Yet even this advocate of developing financial markets is careful to note that

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107. Id. at 33:

Let us take the Shoudu Iron and Steel Complex as an example. During the past 10 years, its labor productivity calculated on the basis of its net output value has increased by 260 percent, with an average annual growth rate of 13.66 percent. This has been faster than the increase of labor productivity of large iron and steel enterprises in developed countries. Of course, such analysis ignores the relative levels of those industries at the beginning of the comparison period, not to mention such factors as the quality of the output and the efficiency of the production processes.


they must develop under the “prerequisites of public ownership and adherence to socialist orientation.” In fact, a subtle argument emerges that stock and bond ownership under the “unified control” of the People’s Bank of China may assist the re-assertion of centralized control of the economy by preventing local government and enterprises from borrowing elsewhere to expand investment outside the confines of the state plan.

Despite this commentator’s enthusiasm for developing the stock and bond markets, he is forced to acknowledge five overarching problems which may impede progress. Fixed interest rates for long-term investments are all the same, regardless of considerations of variable risk of their issuers; “administrative apportionment” interferes with market allocation of newly issued bonds and the secondary market; few intermediaries exist in China to facilitate transactions in securities; legal regulation of securities, both their issuance and their transfer, is “not fully established”; and recordkeeping methods are extraordinarily backward, in most cases being done by hand.

In the end, whether or not China determines to expand the experiment with security-holding and the attendant economic reforms or returns to an earlier model of socialist public ownership, the market will continue to be an afterthought. Political and programmatic concerns will decide the course and the speed of progress, with economic phenomena forced to conform to their dictates, rather than proceeding organically from the natural evolution of a dynamic economy. The ability of such a system to propel China into industrial modernity remains problematic.