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HEADLINE: CHINA INTRODUCES A WIDE RANGE OF LEGAL REFORMS;
TARGETS INCLUDE INVESTMENT AND FINANCIAL SYSTEMS, STATE-OWNED ENTERPRISES, JUDICIAL SELECTION.;
In Focus: Pacific Rim

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TARGETS INCLUDE INVESTMENT AND FINANCIAL SYSTEMS, STATE-OWNED ENTERPRISES, JUDICIAL SELECTION.

it is axiomatic that China has experienced wide-ranging economic, legal and political changes during the past decade. Since the advent of Deng Xiaoping's economic reforms in the 1980s, China has undergone a rapid transformation at almost every level of society. From allowing free elections for village chiefs to developing a rapidly expanding market economy with Chinese characteristics, the China of the late 1990s has roared into the global commercial market.

The continuing Asian financial crisis undoubtedly has slowed the economic engines of the four tigers of Asia-Hong Kong, Taiwan, Singapore and South Korea. The Chinese tiger has not escaped unscathed, but with its giant consumer marketplace and untapped natural resources, China still boasts tremendous economic growth and investment potential in nearly every sector of its economy. Fueling this growth are myriad proposed legal reforms, the breadth of which promise even greater changes in the future.

The First Session of the Ninth National People's Congress, convened in March, outlined a five-year plan emphasizing wide-ranging legal reforms to correct a variety of economic and social problems. Governing the country by law is an important component of Deng Xiaoping Theory and a basic strategy employed by the CPC [Communist Party of China] in leading the people, declared Li Peng, chairman of the Standing Committee of the Congress, in a well-publicized speech at the end of the First Session.[1]

Among the various areas targeted for reform by the CPC are the investment and financing systems; the housing system; state-owned enterprises, or SOEs; and government institutions. Proposed reforms include administrative streamlining and the perfecting of legal enforcement mechanisms to increase efficiency and reduce corruption.[2] These goals have led to expansive changes that have a direct impact on the types and nature of direct foreign investment allowed by law.

In China, foreign direct investment, or FDI, is governed by a complex set of regulations that permit equity and cooperative joint ventures with Chinese partners, as well as wholly foreign-owned ventures. To qualify for direct investment, a foreign venture must satisfy one of four specific requirements: the adoption of advanced technology and scientific management, the beneficial technical renovation of an existing enterprise, the expansion of exports or the training of Chinese personnel.[3]

In addition, wholly foreign-owned enterprises must export at least half their annual output or must rely heavily on advanced technology whose application is considered beneficial to China.[4] Wholly foreign-owned ventures are approved far less frequently than are joint ventures, although the approval rate has increased over the past year.[5]

For many years, direct foreign investment generally was not permitted in the national defense, transportation, communications, public media, culture or education industries. Service industry participation was limited to daily living services, such as lodging, dining and repair services, and did not include banking, insurance, commerce or trade. With the exception of defense, communications and media, those limitations have all but disappeared. Even the Civil Aviation Administration of China recently announced its intention to raise permissible foreign investment levels in domestic airlines from 35 percent to 40 percent.[6]

Infrastructure Investment

In an effort to expand foreign investment in infrastructure, provisional draft regulations, allowing FDI in build-operate-transfer, or BOT, projects under a modified franchise system, have been circulated.[7] The regulations, most recently modified in April, propose an international competitive bidding process for award of foreign contracts to build and operate specific infrastructure projects,[8] including coal-fired power stations and hydropower stations of less than 250 megawatts, high-grade roads, local railways, bridges, tunnels, city water supply sources, water purification plants and sewage treatment plants.[9]

The successful bidder for an approved project must contribute registered capital of no less than 25 percent of its total investment.[10] The project company established pursuant to these regulations will be a limited liability company entitled to ownership and management rights in project facilities during the franchise period.[11] This franchise period may not exceed 30 years.[12]

The project company is also responsible for training personnel required to assume independent responsibility for the operation and maintenance of the project after [its] transfer.[13] Upon expiration of the BOT contract, the project company must, without reservation, give the government authorities the technology and data related to the operation and maintenance of the project, without any compensation.[14]

Disputes concerning a BOT agreement must be settled through friendly consultation.[15] If such consultation is unsuccessful, the regulations require submission to either a Chinese arbitral body or other arbitral bodies.

Given the stated government desire to expand infrastructure projects through FDI, it is anticipated that these regulations will be adopted quickly. It is less clear, however, whether the regulations actually will increase FDI, given their continued emphasis on the uncompensated transfer of technology at the contract period's end.

Despite a burgeoning number of foreign joint ventures, more than 40 percent of China's industry remains composed of SOEs,[16] which employ 56 percent of the urban population, yet contribute only 20 percent of the country's gross national product.[17] Inefficient and bloated, with indifferent workers and outdated equipment, SOEs were, until last October's 15th National Party Congress, considered sacrosanct.

As originally conceived and currently operated, SOEs serve as one of the original building blocks of Chinese socialist society. The SOE is not simply an employer. The dawei, or work unit, serves as the security net for society, providing housing, guaranteed lifetime employment, schooling and pensions.

Because both industries and financial institutions were wholly state-owned, poorly run SOEs were entitled to nearly unlimited funds with no guarantee, or even expectation, that loans from state-owned banks would be repaid. The practice not only burdened the state with the ownership of competitively inefficient industries, but also with the banks, whose heavy bad-debt portfolios precluded their providing funds to economically viable foreign and private ventures.

A Surge in Sales of SOEs

Increasingly, China's laws are changing to facilitate FDI in SOEs. In a speech before the National Party Congress last September, Jiang Zemin suggested that reform of SOEs could be advanced, in part, through the sale of smaller SOEs. This gave the green light to bargain-basement sales of SOEs by provincial governments.[18] Among the beneficiaries of these loosened regulations was Eastman Kodak Co., which recently purchased three SOEs in the photographic industry.[19]

Burdens on purchasing SOEs have been alleviated further by the reduction in social services SOEs are required to provide. As of April, work units no longer are required to provide housing. In fact, one stated goal of the NPC is the elimination of all housing subsidies.

Property laws have been revised to encourage a growing real estate market. Although the land remains largely state-owned, private individuals may buy and sell buildings and individual apartments. In fact, to encourage the development of private ownership, as of June 1 even residents in government-subsidized housing are allowed to sell their land-use rights without restriction.[20]

Because housing costs remain relatively high, Chinese consumers are increasingly using mortgage-type financing to purchase new, privately owned homes. To spur investment, the Shanghai Property and Land Administration Bureau has lowered the down payment on new home purchases from 30 percent to 20 percent for city residents who use the government's Housing Fund to finance the rest of their purchases.[21] It is anticipated that increased demand for funds to buy private housing may lead to additional regulation of financing practices, including laws governing foreclosure, collateral and bad debt write-offs.

Banking reform also is under way. China's central bank has begun to close dozens of local People's Bank of China branches, replacing them with regional central banks, following the model of the U.S. Federal Reserve System.[22] Banks are also required to adopt Western financial accounting practices to improve accountability and assist examiners in making future loan determinations.[23]

The development of a market economy, and concomitant rise in the standard of living, has increased the disposable income of the average worker, as well as the variety of consumer goods on which such income may be spent. With increased affluence has come increased legal protection against unfair practices.

Consumer Protection

The Law on Protecting Consumers' Rights and Interests, adopted Oct. 31, 1993, provided a wide range of civil and criminal remedies for false advertising, abusive practices and the sale of defective, dangerous and illegal products. The statute recognized that it was the common responsibility of all strata of society to protect the legitimate rights and interests of consumers.[24]

To meet this responsibility, the statute places the burden of enforcement on the general public. It requires the mass media to publicize the need to protect the legitimate rights and interests of consumers and [to] enlist public opinion in overseeing actions that hurt such rights and interests.[25]

The law further authorizes the formation of social groups to safeguard [the public's] rights and interests.[26] To encourage public enforcement, the statute provides a wide range of remedies, including compensation in accordance with the law for personal and property damages incurred as a result of the purchase and use of commodities or receipt of service in violation of the statute.[27] It also provides for monetary compensation of twice the price paid if a business operator has committed fraud in providing goods or services.[28]

Consumer protection has received much press, including extensive coverage of the March 15

World Consumer Rights Day forum.[29] The case of Wang Hai and the money he earned buying counterfeit products at Beijing department stores and then seeking compensation for violations of consumer laws was widely reported as an example to follow.[30]

To further strengthen consumer protection efforts, new rules detailing and defining how cases of infringement on consumers' interests and rights should be handled by local authorities are being drafted. Details of these proposed rules were not available at press time, but they are expected to provide for expedited handling of consumer complaints by administrative authorities and to provide lists of the types of acts considered violations.

In April, in response to reports of pyramid schemes, direct sales-door-to-door and some instances of direct mailing-were banned.[31] The new regulation has not yet been construed to prohibit telemarketing or direct-marketing brochures, but some have predicted that such expansion may not be far off. Moreover, if the ban is expanded to include direct-marketing techniques, it likely will be applied to advertising or offering for sale of products over the Internet as well.

Although the number of Internet users in China is estimated at only about a million, 'Net use is expanding rapidly. The Implementation Rules for Provisional Regulations of the Administration of International Networking of Computer Information, issued this year, place Internet administrative responsibility, including domain-name registration, with the China Internet Information Center, under the auspices of the State Council.[32] International network connections with China remain limited to channels provided by the national public telecommunications networks of the Ministry of Posts and Telecommunications.[33]

To operate networks, approval must be obtained from the appropriate ministerial authority and requires the submission of a feasibility study that includes economic analysis and safety measures as well as technical information.[34] Network communications remain subject to supervision and censorship by the Public Security Bureau, although the extent of such supervision is unknown.[35] Access to certain Web sites, including that of The New York Times, remains blocked.[36]

Legal System Reforms

Perhaps the most important legal change in China is the growing effort to reform the legal system. On March 17, 1996, the Fourth Session of the Eighth National People's Congress approved the Ninth Five-Year Plan for National Economic and Social Development and the Long-term Development Program for 2010, setting the ambitious goal of ruling the country by law and building a socialist country ruled by law. In previous years, efforts to achieve this goal have focused primarily on the enactment of new laws and regulations. In the past five years, China has enacted more than 110 laws and regulations.[37]

Legal reform continues to focus on enactment of new legislation and regulations, including securities, investment fund management and unified contract laws. This year, however, the focus has shifted toward perfecting the operation of the legal system itself.

Prior reforms have been directed toward making trials more open to the public and improving the reinvestigation of cases involving purportedly unjust sentences. The current reforms, however, are directed toward reducing corruption and inefficiency in the system.

One of the ills identified for correction is the method of judicial selection. Under the current system, judges are selected by local People's Congresses.[38] This local selection process promotes protectionism and has led to the enforcement of local laws in contravention of national law. It has also led to the appointment of an excessive number of court personnel, including many with no knowledge of the law. Whether an acceptable alternative can be found, however, is uncertain, given the growing movement toward local autonomy in matters of local concern.

Another problem is lack of education of lawyers and judicial personnel and the reliance on a system of guanxi-favor for favor-as opposed to law for rights determinations. Methods of achieving these goals include the development of regulations governing the handling of legal disputes by court personnel; enhanced training and legal education opportunities, including reform of the legal education system; and public education.

Although legal reform and implementation of the rule of law have been a constant refrain in recent years, perfection of the legal system is expected to garner renewed priority because of increasing recognition of the critical role an improved system will play in meeting the challenges of China's transformed economy. President Clinton's recent visit has focused renewed attention on rule of law as a critical issue for the Chinese tiger's role in Asia's economic future. Deeply embedded in Chinese culture, however, is formalism-a belief in enactment of laws with little concern for their enforcement-which may be a nearly insurmountable obstacle to China's transformation into a 21st-century legal system.

a. **Ms. Long is an associate professor at John Marshall Law School in Chicago. She recently served as a Fulbright professor at Jiao Tong University in Shanghai, China, where she taught international intellectual property and trade law.**

1. Ji Tao, Li Outlines NPC's Transcentury Goals, China Daily, March 20, 1998.

2. Zhu Charts Development Course, Excerpts From Premier Zhu Rongi's Press Conference, China Daily, March 20, 1998.

3. See generally Sino-Foreign Equity Joint Venture Law (http:// qis.net/chinalaw/lawtran1.htm).

4. See Wholly Owned Foreign Owned Enterprise Law (http:// qis.net/chinalaw/lawtran1.htm); Implementation Regulations for Wholly Owned Foreign Owned Enterprise Law (http://www.chinainfonet.com/guide/laws).

5. Among foreign companies that recently established wholly owned ventures are AT&T and Ericsson. Because of vagaries of regulations and the perceived need to have contacts a local Chinese partner can bring, such enterprises generally have not been favored by foreign investors. AT&T and Ericsson established wholly owned management companies only after several years' experience in China.

6. CAAC Considers Raising Foreign Investment Ratio, China Daily, May 11, 1998. On Dec. 31, 1997, the State Planning Commission and Ministry of Foreign Trade and Economic Co-operation promulgated a Catalogue for the Guidance of Foreign Investment Industries, listing 26 priority industries, most of which are heavily technology-oriented.

7. Provisional Regulations on Foreign Investment Build Operate Transfer Projects (http://qis.net/chinalaw/lawtran1.htm).

8. Id. at Art. 4.

9. Id. at Art. 5.

10. Id. at Art. 4.

11. Id.

12. Id.

13. Id. at Art. 25.

14. Id. at Art. 25.

15. Id. at Art. 28.

16. Congress Theory Benefits its Productivity, China Daily, Jan.19, 1998.

17. Fred Hu, Stimulus Can Reinforce China's Reforms, China Daily, Aug. 5, 1998, at 6.

18. The government has not limited SOE solutions to mergers and sales. To trim SOE operating deficits, the government has earmarked 40 billion yuan ($4.8 billion) to write off bad debts of 1,500 to 2,000 SOEs, by merging them with others or forcing them into bankruptcy. Sun Shangwu, SOE Deficits to be Turned, China Daily, March 19, 1998.

19. Hu, supra n.17.

20. Karby Leggett, Shanghai Launches Reform of Property, Dow Jones Newswires, June 3, 1998.

21. Shanghai Sets Rules to Spur Private Home Buying, Asian Wall St. J., June 8, 1998, at 4. The Housing Fund is government-operated, created through a 6 percent tax on monthly earnings by local residents.

22. Peter Wonacott, All Eyes on China-The American Way: With Its Asian Neighbors Struggling, China's Leaders Have Found a New Economic Model: The U.S., Asian Wall St. J., May 11, 1998, at 3.

23. Id.

24. Law on Protecting Consumers' Rights and Interests, at Art. 6.

25. Id.

26. Id. at Art. 12.

27. Id. at Art. 11.

28. Id. at Art. 49.

29. See, e.g., World Consumer Day Focuses on Self-Protection, China Daily, March 2, 1998.

30. In an eight-month period, Mr. Wang, a 23-year-old former store clerk, purposefully sought out and purchased 14 batches of counterfeit or otherwise shoddy products, most with famous trademarks. He ultimately succeeded in obtaining about $938 in compensation and was commended by the National Anti-Counterfeit Office.

31. Before the ban, 22 companies were authorized to deal in direct sales, including Amway, Mary Kay and Avon. State Bans Pyramid, Direct Sales Schemes, China Daily, April 28, 1998.

32. Implementation Rules for Provisional Regulations of the Administration of International Networking of Computer Information, Arts. 5 and 6, 131 International Business, Issue 5 (1998).

33. Id. at 7.

34. Id. at Arts. 10 and 11.

35. In Shanghai, from February to June, the author experienced attempts to censor e-mail, including blocked sites and delays in receipt to permit review of content. Others described receipt of warning letters from the Public Security Bureau for sending e-mail containing proscribed terms, such as dissident and democracy movement.

36. The New York Times' site was blocked consistently from February to June. By contrast, the Washington Post's site was blocked only when reports criticizing President Clinton's planned state visit became prevalent.

37. Hong Xia, Members See Need for Society of More Law, China Daily, March 3, 1998.

38. Legal Reform to Keep Pace With Market, China Daily, Feb. 20, 1998.

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