ARTICLES

WHAT'S LAW GOT TO DO WITH IT? LEGAL INSTITUTIONS AND ECONOMIC REFORM IN CHINA

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This Article began as a paper written as part of an American-European-Chinese joint project researching reforms in the ownership system of Chinese state-owned enterprises. The project is supported by the Ford Foundation and the Institute of Economics of the Chinese Academy of Social Sciences. Citations in the footnotes make apparent but understate my debt to Barry Naughton of the University of California at San Diego for my understanding of the Chinese economy. I also wish to thank Cyril Lin of St. Anthony's College, Oxford, for having brought me into the project. I am grateful to William Alford, Jerome Cohen, John Haley, Nicholas Lardy, Frank Upham, and Louis Wolcher for their attentive reading of earlier drafts and their detailed comments. Remaining errors are mine alone. Finally, I wish to thank the staff of the University of Washington Law Library, and particularly Mary Whisner, for the extraordinary level of research support provided as part of a day's work.

Ruling a big country is like cooking a small fish.[1]

I. INTRODUCTION

The dramatic autumn of 1989 in Eastern Europe showed that real political change can come with astonishing rapidity. Yet reports of the death of state socialism are greatly exaggerated. While the political structure may be withering, the economic institutions have proved much hardier. Governments in one country after another have discovered that the transition from a largely planned economy to a largely market economy is an enormously complex and painful process, and democratic political institutions do not necessarily make it any easier.[2]

How far economic reform can go in the absence of political and other institutional reforms is still an open question. For political reform, and especially legal reform, bears crucially on the means available for attaining the ends of economic reform. From China to Czechoslovakia, the currently and recently socialist countries face many similar problems in their efforts at economic reform. Yet their attitudes toward political and legal reform are quite different. This Article is an effort to explore in one country the interaction between policies of economic reform and the political and legal institutions that are available to implement those policies.

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1. LAO TZU, ch. 60, *translated in* WING-TSIT CHAN, A SOURCE BOOK IN CHINESE PHILOSOPHY 168 (1963).

2. The sharp distinction sometimes drawn between "planned" economies and "market" economies is, of course, false. Many of the so-called planned economies have significant non-planned sectors, such as agriculture in Poland. In the United States, on the other hand, agricultural markets are subject to significant government intervention. Nevertheless, there is a difference between an economy where a few state-owned institutions must do most of their buying and selling at market prices and an economy where a few non-state actors must operate in a world of fixed prices bearing little relation to supply and demand.

In 1978, the People's Republic of China (PRC) began a major program of economic reform. The reforms were prompted by dissatisfaction with the results of the traditional system of collectivized agriculture and planned industry and commerce. Their essential aim was the devolution of economic decision making power from higher to lower level governmental bodies and, in some cases, the transfer of such power out of the bureaucratic hierarchy altogether. So far, most scholarly analysis has been concerned with the contents of reform policies. Yet the means available to the government to effect these policies have been less well studied.[3] The most enlightened policies are useless if for some reason they cannot be implemented.

It is no accident that the period of reform has coincided with the period of "legalization": the effort by the government to enhance the role of law and legal institutions in Chinese society. Indeed, a primary vehicle for reform has been the promulgation of a series of statutes and regulations prescribing the means by which economic change is to be effectuated. Yet passing laws is not enough. Statutes can be effective only within an appropriate institutional framework. Where that framework does not exist, statutes and the policies they embody will wither and die.

This Article is a study of the use of law and legal institutions to effect industrial reform in China. It argues that the content of reform policy is inseparable from the vehicle in which it is expressed. While law is often in principle the most appropriate vehicle for reform policies, the effectiveness of particular statutes and regulations is compromised by the institutional environment in which they must operate. Without a fundamental reform of the legal system, which in many ways has yet to be accomplished, thorough industrial reform cannot be achieved.

Part II of this Article presents some necessary background for the non-China specialist. It introduces the planning system, economic reform, the state-owned industrial enterprise, and the concept of the soft budget constraint. It also introduces a major organizing theme of the Article: the conflict between the central government and local authorities.

Part III discusses the role of law in economic reform. It considers various possible approaches to policy implementation and the reasons why the government has stressed the role of legal institutions. This part then provides an overview of legal institutions in the PRC, looking at the formal structure of the state, various lawmaking bodies, and the courts, as well as informal elements of their functioning.

3. One excellent collection of studies is POLICY IMPLEMENTATION IN POST-MAO CHINA (D. Lampton ed. 1987).

Part IV sets the stage for the consideration of particular rules that attempt to further policies of reform. Proceeding from the assumption that not all rules will be equally effective, I propose a set of questions that could be asked about any rule. The hypothesis of Part IV is that to the extent we can answer these questions, we can predict the effectiveness of a rule.

In Part V, I use case studies to make concrete the sometimes abstract ideas presented in Part IV. This Part examines rules forbidding the unauthorized levying of fees on enterprises by local governments, rules purporting to give enterprise managers wide powers to hire and fire enterprise personnel, and rules providing that loss-making enterprises should go out of business.

While Part V looks at rules themselves, Part VI takes a closer look at the key institutions involved in the implementation of legal rules designed to affect enterprise behavior: courts and the enterprise's administrative superior. It argues that neither is well suited to enforce legal rules.

Part VII reviews the connection between form and substance in reform policy and asserts that the failure to reform the legal system in certain necessary ways can fatally compromise the effectiveness of laws designed to implement reform.

II. BACKGROUND TO REFORM

A. Economic Reform in China

Economic reform in China dates from the watershed Third Plenum of the 11th Central Committee of the Chinese Communist Party (CCP) held in December, 1978.[4] There the CCP announced that the central focus of its work would shift from class struggle to economic development.[5]

In the rural sector, the expansion of free markets for agricultural produce and the introduction of the responsibility system have for all practical purposes done away with collectivized agriculture.[6]

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4. For an excellent and often-cited collection of articles on Chinese reforms in general, *see* THE POLITICAL ECONOMY OF REFORM IN POST-MAO CHINA (E. Perry & C. Wong eds. 1985). *See also* Perkins, *The Prospects for China's Economic Reforms*, in MODERNIZING CHINA: POST-MAO REFORM AND DEVELOPMENT 39 (A.D. Barnett & R. Clough eds. 1986).

5. *See Zhongguo gongchan dang di-shiyi-jie zhongyang weiyuanhui di san ci quanti huiyi gongbao* (Communiqué of the Third Plenum of the 11th Central Committee of the Communist Party of China), *adopted* December 22, 1978, *reprinted in* 1 SHIYI-JIE SAN ZHONG QUAN HUI YILAI ZHONGYAO WENXIAN XUANDU (Selected Readings in Important Documents Since the Third Plenum of the 11th Central Committee) 1 (Zhonggong zhongyang wenxian yanjiu shi (Chinese Communist Party Central Committee Documentary Research Office) ed. 1987).

6. *See* Perry & Wong, *Introduction: The Political Economy of Reform in Post-Mao China: Causes, Content, and Consequences*, in THE POLITICAL ECONOMY OF REFORM

These reforms have generally been considered successful, although to some extent the achievements represent one-time gains brought about by higher prices to farmers and have little to do with other institutional changes.[7]

Encouraged by the results achieved in agricultural reform, the CCP in 1984 decided to reform the urban industrial economy.[8] Because the reforms were aimed at many of the real and imagined faults of the planning system, a brief digression to describe that system is necessary.

China has many of the characteristic institutions of a Soviet-style centrally planned economy.[9] At the top of the system of planning institutions is the State Planning Commission (SPC). Individual commodities are planned in physical terms. The SPC sets initial rough output targets, which are then sent to various industrial ministries under the State Council and to provincial planning commissions. They respond with projected outputs and input requirements. After several iterations of this process, the SPC comes up with a roughly consistent set of output targets, investment projects, and supply requirements. The ministries and provinces then disaggregate these targets and add requirements of their own before passing them on to particular enterprises.[10]

Contrary to popular belief, the Chinese economy has never been completely planned from the center, and even in the past reform was substantially less planned than other centrally planned economies.[11] In the Soviet Union, for example, some 60,000 com-

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IN POST-MAO CHINA 1, 10 (E. Perry & C. Wong eds. 1985); *see also* Perkins, *supra* note 4, at 49.

7. *See* Perry & Wong, *supra* note 6, at 22. Barry Naughton notes that crop production has grown only slowly since 1984 and that grain production has never surpassed the record level of that year. *See* Naughton, *Inflation and Economic Reform in China*, 88 CURRENT HISTORY 269, 271 (1989).

8. The landmark document containing this decision is *Zhonggong zhongyang guanyu jingji tizhi gaige de jueding* (Decision of the Central Committee of the CCP on Reform of the Economic Structure), *adopted* October 20, 1984, *reprinted in* 2 SHIYI-JIE SAN ZHONG QUAN HUI YILAI ZHONGYAO WENXIAN XUANDU (Selected Readings in Important Documents Since the Third Plenum of the 11th Central Committee) 766 (Zhonggong zhongyang wenxian yanjiu shi (Chinese Communist Party Central Committee Documentary Research Office) ed. 1987); *translated in* BEIJING REV., Oct. 29, 1984, at I [hereinafter Decision on Economic Reform]. On reform of the industrial economy in general, see C. RISKIN, CHINA'S POLITICAL ECONOMY 341-75 (1987).

9. This paragraph is based upon Naughton, *Industrial Planning and Prospects in China*, in U.S.-CHINA TRADE: PROBLEMS AND PROSPECTS 179, 180 (E. Lawson ed. 1988).

10. For a helpful chart, see Lyons, *Planning and Interprovincial Co-ordination in Maoist China*, 1990 CHINA Q. 37, 42.

11. *See generally* Naughton, *supra* note 9, on which this paragraph is based. *See also* Naughton, *China's Experience with Guidance Planning*, 14 J. COMP. ECON. 743, 745 (1990) ("Since the 1960s, Chinese planners have never disposed of the kind of total control of the economy that is normally taken to be a characteristic of the Soviet-type economic system."). A typical example of the usual picture of comprehensive central

modities are planned and distributed from the center; in China this figure has rarely exceeded several hundred.[12] First, in the 1980s, central planning authorities allocated fewer than 100 commodities.[13] Second, a large amount of ostensibly "planned" commodities are subject to local, not central, plans. Uncoordinated planning is to that extent not planning at all.[14] Third, a significant amount of investment, control over which is generally held to be the mark of the superiority of the planned economy, takes place outside the plan. In 1977, before reform, some forty percent of investment in state units was not centrally planned. Between 1982 and 1985, that figure rose to sixty percent, an extraordinary number for a centrally planned economy.[15] Finally, the tremendous problems of information, coordination, technology, and politics that must be overcome in planning for such a vast nation cannot be ignored: a good deal of planning took place only on paper and was never effectuated. One scholar has concluded that "for most of the 1970s, China was not governed by any operational long-range plan at all."[16]

The primary goal of industrial reform was to maintain direct control over only the core of the economy. The dispersed sectors

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planning can be found in Wang Haibo, *Greater Power for the Enterprises*, in CHINA'S ECONOMIC REFORMS 67 (L. Wei and A. Chao eds. 1982). Wang describes the pre-reform system as one where local authorities and enterprises had to fulfill mandatory production targets dictated by the central authorities, regardless of their suitability, and where "*[a]ll* investments in extended reproduction and other expenses [were] also centrally controlled . . . ." *Id.* at 67 (emphasis added).

12. *See* Naughton, *supra* note 9, at 181; Wong, *Ownership and Control in Chinese Industry: The Maoist Legacy and Prospects for the 1980s*, in JOINT ECONOMIC COMM., CHINA'S ECONOMY LOOKS TOWARD THE YEAR 2000, VOL. 1: THE FOUR MODERNIZATIONS, S. Doc. No. 149, 99th Cong., 2d Sess. 571, 577 (1986).

13. Although the number of commodities theoretically subject to central allocation was 256, the actual number was much smaller. *See* Naughton, *supra* note 9, at 181. In any case, even the theoretical figure of 256 in 1984 had by 1989 been reduced to 26. *See* Yu Yali & Huang Taiyan, *Jianli jingzheng shichang de chanye zuzhi zhengce xuanze* [The Choice of Industrial Organization Policies for a Competitive Market], JINGJI YANJIU [Economic Studies], No. 10, 1990, at 70. Such a small number implies that the categories are highly aggregated; for example, a single balance is struck for "cement" or "lumber" without regard for quality or variety. This means that key decisions remain to be made at the sub-central level. In 1978, for example, Shanghai reportedly allocated roughly 8,000 commodities, as compared with fewer than 1,000 allocated from the center. *See* Lyons, *supra* note 10, at 50.

14. *See, e.g.*, Zweig, Hartford, Feinerman & Deng, *Law, Contracts, and Economic Modernization: Lessons from the Recent Chinese Rural Reforms*, 23 STAN. J. INT'L L. 319 (1987), where the authors first describe a "command economy that . . . subordinated the rural people's communes and their peasant farmers to the dictates of the state plan[,]" but in the next paragraph speak of "a rural economy . . . dominated by arbitrary actions of local officials" (footnotes omitted). *Id.* at 320. If local officials were the real decision makers, then central planners were not.

15. *See* Naughton, *supra* note 9, at 182; *see generally* Naughton, *The Decline of Central Control over Investment in Post-Mao China*, in POLICY IMPLEMENTATION IN POST-MAO CHINA 51 (D. Lampton ed. 1987).

16. Naughton, *supra* note 11, at 748; *see also* C. RISKIN, *supra* note 8, at 281-282.

that were not in any case amenable to effective direct control were to be placed more on a market basis, leading to improved efficiency.[17] Economic development would be promoted by freeing the energies of enterprises and workers from the supposedly stultifying bonds of excessive state control and dependence.[18]

The reforms centered on state-owned enterprises. "State-owned" is deceptively difficult to define in a politically or economically meaningful sense. Generally, a state-owned enterprise is one that is controlled by one or more units of government at or above the county level.[19] The power of management and control over output — as well as responsibility for supplying inputs — can thus rest in any of one or several bodies with divergent interests and goals. To speak of ownership by the state, therefore, implies a monolithicity and unity that does not exist. As far as the enterprise is concerned, the state can be any institution from a central ministry to a local government.[20] The concept of the state in this context thus becomes fragmented. Put simply, the state must be conceptualized as an entity which is capable of pursuing contradictory and inconsistent policies.[21] This is one aspect of state control through plan-

17. *See* Naughton, *supra* note 9, at 183.

18. *See* Decision on Economic Reform, *supra* note 8, at IV. Compare this vision with that of Lenin:

> Any large-scale industry — which is the material source and foundation of production in socialism — unconditionally must have a rigorous, unified will to direct the collective work of hundreds, thousands, and even millions of men. But how can the rigorous unity of wills be assured? Only by the wills of the thousands and millions submitting to the will of a single individual.

2 V.I. LENIN, SELECTED WORKS 398 (Moscow 1952), *cited in* F. SCHURMANN, IDEOLOGY AND ORGANIZATION IN COMMUNIST CHINA 255 (2d ed. 1968).

19. Typically, multiple units of administration will be involved. The Qingdao Forging Machinery Plant provides an extreme case. In the pre-reform period, it received production assignments from both the municipal (*Qingdao*) machine building bureau and the county. Its inputs were supplied by the (National) Ministry of Machine Building, the provincial (Shandong) Bureau of Machine Building, the municipal Bureau of Machine Building, and the county. The county assigned the management personnel, but workers were assigned by the city. As a result of conflicting targets, in 1982 the plant was praised by the province and the city for improving performance, while being criticized by the county for failure to meet its output-value target. *See* Wong, *supra* note 12, at 573.

20. See the chart in Hare, *China's System of Industrial Economic Planning*, in THE CHINESE ECONOMIC REFORMS 185, 189 (S. Feuchtwang & A. Hussain eds. 1983).

21. One writer characterizes "the different branches, vertical or horizontal, of the administration . . . as many little independent 'kingdoms' each following its own objectives . . . ." Zafanolli, *A Brief Outline of China's Second Economy*, in TRANSFORMING CHINA'S ECONOMY IN THE EIGHTIES, VOL. 2: MANAGEMENT, INDUSTRY AND THE URBAN ECONOMY 138, 150 (S. Feuchtwang, A. Hussain & T. Pairault eds. 1988). Chao and Yang are incorrect when they assert that under the pre-reform system (or now) "the state had the right to reassign (*diaobo*) property from one state enterprise to another without compensation." Chao & Yang, *The Reform of the Chinese System of Enterprise Ownership*, 23 STANFORD J. INT'L L. 365, 368 (1987). If both enterprises are controlled by the same "state" administrative unit (for example, the Bureau of Machine

ning that has been perceived as unsatisfactory and in need of reform.

The centerpiece of industrial reforms was profit retention for enterprises. Enterprises were encouraged to seek profits and to enjoy the benefits of those profits. Workers were to have their well-being tied more directly to their performance on the job and to the success of the enterprise where they worked. Market forces were to play a much more important role in the distribution of goods and services. Investment was no longer to be free — state grants of construction funds were to be replaced by bank loans bearing interest. Enterprises could retain more of their depreciation funds, but were to pay charges for their fixed assets and working capital.[22]

Industrial reform has proved exceptionally difficult because of the many interrelated steps required.[23] These steps can be broadly categorized under two headings: first, reforms designed to change the way in which enterprises respond to their environment, and second, reforms designed to change the environment within which enterprises operate.

The first type of reforms, internal reforms, are necessary because experience teaches us that merely *telling* enterprises to strive to increase profits and avoid losses is insufficient. They must have a reason for doing so. They must have an incentive[24] to minimize the

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Building of Province X), the transfer is without significance: the Bureau is simply taking from one pocket and putting into another. The relevant quotas for the enterprise losing the property would be adjusted appropriately. If the enterprises are controlled by different administrative units, such a transfer will not take place without appropriate compensation and may not take place at all, even where it would be economically efficient for it to occur. A recent study of planning in the pre-reform era found that "[c]oal for a central iron-and-steel complex is more likely to come from a central mine in another province than from a provincial mine next door — regardless of extraction and transport costs." Lyons, *supra* note 10, at 59. Yet the iron-and-steel complex and both mines would all be called "state-owned."

22. *See* Perry & Wong, *supra* note 6, at 12.

23. For a general look at the complexities of China's economic reforms, *see* D. PERKINS, CHINA: ASIA'S NEXT ECONOMIC GIANT? 67-71 (1986). The same sort of problems, albeit in a Polish context, are concisely and lucidly described in Sachs & Lipton, *Polish Economic Reform*, FOREIGN AFFAIRS, Summer 1990, at 47, 52-54. There is a continuing debate over the relative merits of a gradualist versus a Big Bang approach to economic reform. The latter approach can be extremely traumatic. Yet the gradualist approach often just makes things worse — like a gradual reform from driving on the right to driving on the left. The best entry I have seen so far in the pithy-metaphor stakes is that of William Nordhaus:

> No one doubts that a fish [a market economy] swims better than a dog [a command economy]. But dogs do swim in their own funny way. And replacing a dog's legs with a fish tail, in a step-by-step reform of canine navigation, would quickly produce one sad pup.

Nordhaus, *Soviet Economic Reform: The Longest Road*, BROOKINGS PAPERS ON ECONOMIC ACTIVITY, No. 1, 1990, at 287, 301.

24. By incentive I mean anything subjectively perceived by the actor as a good reason for doing something. Incentives can, of course, be non-monetary. Such a definition of incentives might be thought too broad to be useful. It requires us, however, to

use of expensive inputs and to maximize the use of cheap ones. They must have an incentive to invest only when the payoff is greater than the cost of capital. Chinese state-owned enterprises have not until now operated under such a system of incentives and disincentives. Instead, they have operated under a "soft budget constraint," leading to characteristic wasteful behaviors that have been considered undesirable in varying degrees at different times. The essence of the soft budget constraint is the notion that the difference between proceeds of production and costs of production is not a matter of life and death for the firm.[25] Therefore, the difference does not act as an effective constraint on firm behavior. The major harmful consequence is that firms do not economize because nobody in the firm suffers the consequences of waste.[26] Those consequences are externalized and are borne by society as a whole. Kornai lists five conditions, each sufficient to render the budget constraint soft.[27]

1. *The firm is a price maker, not a price taker.* If the firm is a price maker, it can impose its own cost increases on the buyer. This imposition may be possible because the seller is stronger than the buyer — for example, a monopolist faced with many scattered buyers, or a chronic shortage of the product in question.[28] It may also be possible because the seller exerts a strong influence on the administrative authority formally responsible for determining the price of the product. According to Kornai, "[c]ontinuous imposition of all costs on the buyer is made possible ultimately by the fact that total demand in money terms is not strictly limited but adjusts more or less passively to the rising level of costs."[29] Buyers, also under a soft budget constraint, have little incentive to resist price increases.

2. *The tax system is soft.* The firm can influence the formulation of tax rules; firms can be granted exemptions or postponements as individual favors; or taxes are not collected strictly.

3. *The enterprise receives free state grants.* The enterprise

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ask certain questions. What are the "good reasons" for which enterprise managers currently act as they do? Will instructing them to make more profits have any effect on those good reasons? If not, what might?

25. The concept of a soft budget constraint was developed most prominently by the Hungarian economist Jaros Kornai. *See generally*, J. KORNAI, ECONOMICS OF SHORTAGE (2 vols.) (1980).

26. To understand the problems created by the soft budget constraint, imagine the consequences if all of American industry were run along the principles that govern defense procurement.

27. The features of hard, almost-hard, and soft budget constraints are outlined in J. KORNAI, *supra* note 25, at 302-314.

28. Shortages will result when the maximum price allowed is lower than the market-clearing price. As buyers' budget constraints become softer, demand, and with it the market-clearing price, increases. When the budget constraint is perfectly soft, demand is, in Kornai's words, "insatiable."

29. J. KORNAI, *supra* note 25, at 307.

may be awarded grants including non-repayable investments and ad hoc subsidies.

4. *The credit system is soft.* The firm is granted credit even where its ability to repay is doubtful, and loans are frequently forgiven. Chinese bankruptcy law, for example, provides that failing firms should be eligible for extra loans on concessionary terms. From the standpoint of credit risk, of course, failing firms would be the *least* likely candidates for such loans.

5. *External financial investment is made on soft conditions.* Owners invest money from their own resources not to develop and enlarge the firm but in order to help it out of financial difficulties. Where the firm is state-owned, this condition is indistinguishable from the free state grants enumerated in (3).

The soft budget constraint has the following consequences:

1. *The firm is not compelled to ensure that proceeds from sales exceed costs from production.* Even a permanent imbalance may be counterbalanced by tax exemptions, state subsidies, and soft credit. Making a profit is not a question of life or death for the firm.

2. *Growth does not depend on internal financial accumulation.* The enterprise can be funded free from outside sources and therefore has no incentive to accumulate profits for reinvestment.

3. *The firm is not compelled to adjust to prices under all circumstances.* It takes note of prices if it feels like it and does not take note of them if it does not feel like it. The firm can adjust to prices internally, by changing its production process. It can also adjust externally, however, by passing along cost increases or lobbying with the authorities to obtain a bigger tax break or a subsidy.

4. *The firm does not bear risk alone, but shares it with the state.* The firm will be subsidized if it loses money, and cannot be sure of keeping all that it gains. The firm's financial position is determined at least as much by its success in bargaining with the authorities as by its success in business.

5. *The firm has excessive demand.* As a result of the consequences above, the demand of the firm for inputs is almost insatiable. To the extent this is true for firms as buyers, firms as sellers will be able to pass on all their cost increases.

The behavioral consequence of the soft budget constraint is that financial factors are unable to operate as effective constraints on the firm's behavior. The soft budget constraint exists only as an accounting relationship.

Many of the conditions for the soft budget constraint exist in China. Investment funds, for example, have traditionally been received as state grants.[30] In 1981, the government began a policy of

30. *See* K. HSIAO, MONEY AND BANKING IN THE CHINESE MAINLAND 11 (1984).

requiring that all capital construction appropriations for enterprises with independent accounting be in the form of interest-bearing bank loans,[31] but this change of policy is unlikely to produce any change in enterprise behavior so long as a rise in expenses, in this case the cost of capital, does not produce any actual suffering.[32] The tax system is also remarkably soft.[33] Local authorities have broad authority to grant tax exemptions and reductions,[34] and central authorities have difficulty keeping them under control when only 600 of China's nearly half a million tax officials are appointed by the central government.[35]

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31. *See Guowuyuan jueding mingnian jijian bokuan gaiwei daikuan* (State Council Decides From Next Year to Change From Allocations to Loans of Funds for Basic Construction), Renmin ribao (People's Daily), Nov. 27, 1980, at 2; K. HSIAO, *supra* note 30, at 11.

32. Notwithstanding the statement of one analyst of Chinese banking that "increased interest charges for loans force the borrowers to economize on money capital," *see* K. HSIAO, *supra* note 30, at 61, a Chinese author seems more accurate in asserting that enterprises will not respond to price and macroeconomic controls such as interest rate policies, which will therefore not work if all the consequences of those price rises can be passed on to consumers or the state. *See* Zhou Yilin, *Fa shi hongguan jianjie kongzhi de "zhongjie"* (Law is a "Medium" for Indirect Macroeconomic Control), Renmin ribao (People's Daily), Apr. 13, 1987, at 5, *reprinted in* JINGJI FA (Economic Law), No. 2, 1987, at 23.

33. *See, e.g.*, Wong, *Between Plan and Market: The Role of the Local Sector in Post-Mao China*, 11 J. COMP. ECON. 385, 393 (1987) ("[T]he 'harder' prices faced by enterprises at the lower levels (where officials have less price-setting authority) were often partially offset by the 'softer' taxes, with closer working relationships between the tax bureau and the economic planning agencies at the lower levels."); Dai Yuanchen, Li Maosheng, Li Xiaoxi & Du Haiyan, *Near-Term Measures for Freeing Reform from Its Current Difficulties* (in Chinese), JINGJI YANJIU (Studies in Economics), No. 7, 1989, at 3, *translated in* FOREIGN BROADCAST INFORMATION SERVICE, DAILY REPORT: CHINA [FBIS], Sept. 7, 1989, at 28, 32 (noting that local authorities interfere with tax collection by the center); Lü Wanda, *Qianyi difang baohu zhuyi de weihai* (A Short Discussion of the Harmfulness of Local Protectionism), ZHONGGUO SHUIWU (Chinese Taxation), No. 10, 1989, at 53 (noting lax enforcement of tax regulations by local government because of frequent congruence of interests with enterprise); *Zuigao renmin fayuan guanyu renmin fayuan dali zhichi shuishou zhengguan gongzuo de tongzhi* (Notice of the Supreme People's Court on the Strong Support by People's Courts of Tax Collection and Administration Work), Nov. 4, 1989, in ZHONGHUA RENMIN GONGHEGUO ZUIGAO RENMIN FAYUAN GONGBAO (Bulletin of the Supreme People's Court of the People's Republic of China) [SPC BULLETIN], No. 4, 1989, at 19, (asserting tax evasion rate of 50% among state-owned and collectively-owned enterprises).

34. Such authority is too broad, in the view of Gao Shangquan, a Vice Minister of the State Commission for Economic Restructuring, who recently said that "[t]he power to exempt or reduce taxes must be centralized, and exemptions and reductions must be on the basis of industrial policy, incomes policy and regional development policy, not on the basis of differences in ownership system, department, or locality." Gao Shangquan, *Jianding bu yi di jixu guanche zhili zhengdun, shenhua gaige de fangzhen* (Unswervingly Continue to Implement the Policy of Improving the Economic Environment, Rectifying the Economic Order and Deepening Reform), Renmin ribao (People's Daily), Oct. 18, 1989, at 1, 4.

35. Of those 600, 450 are in Beijing, leaving only 150 tax officials in all the rest of China who are not responsible to local authorities. *See* Delfs, *Fiscal Feudalism*, FAR EASTERN ECON. REV., Apr. 6, 1989, at 77, 78. Although local authority granting ex-

The second type of reforms, environmental reforms, center around the restructuring of the price system. What the government really wants is efficient enterprises that optimize their use of scarce resources. But no good way to measure efficiency or scarcity exists. Most goods used by industry have fixed prices. Until the price system is reformed, therefore, profitability will be a poor indicator of efficiency. If the output price is fixed high relative to the fixed price for inputs, profitability will be high regardless of efficiency.[36] Profitability "depends in part on arbitrary pricing and the historical accident of investment allocation."[37] In short, stressing profitability in the absence of price reform may be counterproductive: enterprises would maximize profits on the basis of highly irrational existing prices, which would lead to distorted input and output mixes.[38] The adverse effects of China's distorted price structure would simply be magnified.[39]

Given that profits and losses are, in the absence of price reform, poor indicators of economic efficiency or social value, closing down enterprises simply because they lost money would be irrational. On the other hand, price reform and market mechanisms cannot work unless participants have some reason to respond to market forces. If losses cause no pain and profits bring no benefit to enterprises and their managers, they will have no reason to respond to prices in the desired way. Moreover, if price reform were instituted at approximately the same time as a policy of closing down money-losers, the results would be irrational in the short term: "winners and losers in the dislocations following a sudden decontrol of prices would be determined not by any real contributions to society's economic welfare, but rather by the arrangement of previous distortions in the system."[40]

The many contradictions in the reform process brought China to the brink of an economic crisis in the latter half of 1988. The government responded by implementing an austerity program that fall.[41] The political crisis of May and June 1989 then led to the fall

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emptions and reductions tends to make the tax system soft from the standpoint of the individual enterprise, it is not necessarily soft from the standpoint of the local government, which is generally obliged under China's system of financial contracting to turn over a fixed amount to the central government each year. *See infra* notes 56-57 and accompanying text.

36. *See* Hung & Wiemer, *The Course of China's Economic Reforms 1978-1985*, 23 J. ORIENTAL STUD. 63, 70 (1985).

37. Byrd & Tidrick, *Factor Allocation and Enterprise Incentives*, in CHINA'S INDUSTRIAL REFORM 60, 65 (G. Tidrick & J. Chen eds. 1987).

38. *See* Lin, *The Reinstatement of Economics in China Today*, 1981 CHINA Q. 1, 47.

39. *See* Byrd & Tidrick, *supra* note 37, at 83.

40. Hung & Wiemer, *supra* note 36, at 74.

41. *See* N. Lardy, The Current State of and Outlook for the Chinese Economy 3-4 (statement prepared for the Joint Economic Committee, Congress of the United States,

of CCP General Secretary Zhao Ziyang and a number of his associates. As a result, reforms presently appear to be on hold. Spokespersons for the government assert that it remains committed to reform but wishes to proceed more slowly than before. A plausible explanation for current policies is that they are the result of a stalemate between reformers and those who wish to return to command-style central planning. In some areas, such as urban housing and capital markets, reforms appear to be moving ahead slowly.[42] In other areas, such as industrial policy, central planning appears to be making a comeback.[43] A failure to move forward or backward may thus be the result of paralysis, not conscious policy choice.[44] This Article will proceed on the assumption that economic reform must eventually be resumed sooner or later. As the World Bank noted in a recent report, current retreats from reform seem to be based on the notion that "problems encountered in the course of the reform can now be solved by the very same mechanisms . . . responsible for the distortions that the reform was designed to correct."[45] Recent news stories have reported increased calls for further reform and liberalization. In the words of one Chinese central banker: "[W]ithout real reform, the economic situation will become hopeless. It is only a matter of time and the conditions before we undertake serious reform."[46]

B. Center Versus Region in the Chinese Polity

The system of planning both before and after reform has had important consequences for the distribution of effective power between the center and local governments.

The literature on Chinese political organization generally contains two contrasting images.[47] One is that of the omnipotent center. The country is effectively organized and led from the top, where leaders have the power to ensure compliance from lower levels on most issues at any time. The second image is that of a

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Hearings on the Allocation of Resources in the Soviet Union and China, Washington, D.C., June 28, 1990).

42. *See* Xinhua (New China News Agency), *Housing Reform to Be Speeded Up* (in Chinese), June 6, 1990, *translated in* BRITISH BROADCASTING CORPORATION, SUMMARY OF WORLD BROADCASTS, PART 3: THE FAR EAST [SWB/FE], June 29, 1990, at B2/1 (housing); Cheng, *Counters Revolution*, FAR EASTERN ECON. REV., July 29, 1990, at 54 (capital markets).

43. *See* do Rosario, *Quick Step Back*, FAR EASTERN ECON. REV., Oct. 19, 1989, at 47.

44. *See* Delfs, *Sweet and Sour*, FAR EASTERN ECON. REV., June 21, 1990, at 94.

45. *See id.* (quoting World Bank report *Between Plan and Market*).

46. *See* Sterngold, *Calls for Economic Changes Rise Among Chinese Officials*, N.Y. Times, July 30, 1990, at A1, col. 1.

47. For a fuller explication of the views summarized here and an analysis incorporating both perspectives, *see* K. LIEBERTHAL & M. OKSENBERG, POLICY MAKING IN CHINA: LEADERS, STRUCTURES, AND PROCESSES 135-168 (1988).

bickering, fragmented polity. Sub-central levels of the system have a great deal of power in practice and are willing and able to thwart and subvert the demands of the center.[48] This Article subscribes to the second view.

Even before the commencement of the reform program, the Chinese economy was in many ways highly decentralized.[49] Several waves of decentralization had drastically reduced the power of central planners in favor of local governments and quasi-governmental management bodies.[50] Each time, the failure to pay attention to incentives facing local levels led to a lack of coordination and chaos, resulting in a recentralization.[51] This recentralization, however, was never complete. Planning balances are extremely rough, leaving the working out of details to sub-central bodies, and the central government has never regained the financial control it lost during the Cultural Revolution.[52]

Economic reforms introduced since 1978 have added to the power of local governments vis-à-vis the central government.[53] The quantity of materials traded outside state plan channels has increased greatly.[54] A substantial — perhaps the major — portion of the central government's revenues comes from agreements negotiated with each province over how much it will submit to the center.[55] These revenue sharing arrangements, known as financial

48. Such has frequently been the experience of foreigners doing business in China. Local officials and Beijing can both torpedo purportedly authoritative agreements reached by the other. *See generally* Harding, *From China with Disdain: New Trends in the Study of China*, 1982 ASIAN SURVEY 934.

49. Distinguishing between two types of decentralization: (1) devolution of decision-making power to local governments or other lower-echelon administrative units; and (2) devolution of decision-making power to productive units, *i.e.*, enterprises themselves, is important. While the second type of decentralization has often been advocated, it has never really been accomplished in the state-owned industrial sector. State-owned enterprises are in many respects like close corporations owned and controlled by one or a few governmental shareholders. Even if one could draw a line between the governmental owner and the enterprise (whose managerial personnel are appointed by the governmental owner), it may not be a good idea to do so in the absence of an effective system of rules designed to ensure as far as possible that managers maximized the interests of owner/investors and not of themselves.

50. *See* Naughton, *supra* note 11, at 5; Naughton, *False Starts and Second Wind: Financial Reforms in China's Industrial System*, in THE POLITICAL ECONOMY OF REFORM IN POST-MAO CHINA 223 (E. Perry & C. Wong eds. 1985); *see generally* Lyons, *supra* note 10.

51. *See* Naughton, *supra* note 11, at 745.

52. *See generally id.*; Wong, *Material Allocation and Decentralization: Impact of the Local Sector on Industrial Reform*, in THE POLITICAL ECONOMY OF REFORM IN POST-MAO CHINA 253 (E. Perry & C. Wong eds. 1985).

53. *See, e.g.*, Perry & Wong, *supra* note 6, at 12 ("[T]he reforms have led to an unprecedented decentralization of control over financial and material resources, substantially altering the relationship between the state and the enterprise, and between market and plan in resource allocation.").

54. *See id.* at 14.

55. *See* K. LIEBERTHAL & M. OKSENBERG, *supra* note 47, at 139.

contracting (*caizheng baogan*) have resulted in what is essentially a system of tax farming that leaves the center in a passive position.[56] In sum, changes in the financial system have led to the collapse of central government control over many parts of the investment process.[57]

The degree of local control over investment funds is particularly pertinent to a study of the tools available to the center for policy implementation. Local obedience to the center has traditionally been based upon ideology and finance. The Cultural Revolution destroyed the last remnant of the ideological authority of the center,[58] and economic reforms stressing local initiative have given more financial independence to the regions. The more funds local governments have under their own control, the less they need to listen to Beijing.

As one observer noted in 1985, "[u]ltimately, the central government will inevitably reassert control over much of the economic realm, but whether it does so in a manner compatible with further economic reforms must remain, at this point, an open question."[59] The vast quantity of legislation produced by the central government since 1978 represents precisely this centralization effort. In many respects central legislation has failed to achieve its goal because it was an effort to put new wine — new substantive rules about what enterprises and local governments could and could not do — in the old bottle of pre-reform legal institutions, which remain in many ways unchanged in the position they occupy in the Chinese polity.

III. THE ROLE OF LAW IN ECONOMIC REFORM

A. What's So Special About Legal Rules?

The state can exercise control over state-owned enterprises in

56. One article quotes the remarks of prominent economist Jiang Yiwei: "[A]fter the central government assigned revenue quotas to provinces in the form of contracts, provinces also concluded similar financial contracts with their subordinate counties. As a result, the 2,000 counties throughout the country became 2,000 'feudal manors' . . . ." Luo Liewen & Ruan Jiangning, *The Establishment of Scientific and Democratic Procedures for Making Policy Decisions Must Not Be Delayed Any More — Noted Economist Jiang Yiwei Bitterly Points Out Various Defects of Current Policy-Making Procedures* (in Chinese), Shijie jingji daobao (World Economic Herald), Apr. 17, 1989, at 1, *translated in* FBIS, May 5, 1989, at 22, 23. For a similar observation, see Delfs, *supra* note 35, at 77. The feudal metaphor is quite widespread among Chinese economists. For an extended analysis of China's economy based on this metaphor, *see* Shen Liren & Dai Yuanchen, *Woguo "zhuhou jingji" de xingcheng ji qi biduan he genyuan* (The Formation of Our Country's "Baronial Economy" and Its Shortcomings and Roots), JINGJI YANJIU (Studies in Economics), No. 3, 1990, at 12.

57. *See* Naughton, *supra* note 50, at 226.

58. *See* Pye, *China: Erratic State, Frustrated Society*, FOREIGN AFFAIRS, Fall 1990, at 56, 61.

59. *Id.* at 225.

many ways. It can exercise control through ownership because, as the owner, it is the hierarchical superior of the enterprise. The state can exercise control through law because the enterprise, like all other enterprises and persons within the territory of the People's Republic of China, is subject to the state's sovereign jurisdiction. If the state already owns the enterprises whose behavior it wishes to influence, why bother with legal regulation?

On one level, there is no essential or necessary distinction between regulation by the owner and regulation by the sovereign. The owner can take all the enterprise's profits ("dividends") and so can the sovereign ("taxes"). The owner can designate the enterprise's manager; so, in principle, can the sovereign. Indeed, if the United States government took all the profits of General Motors and appointed its top management, it would be considered the owner for all practical purposes, and its act would probably be considered a fifth amendment taking. Thus, although speaking of *legal* regulation is possible in principle, regulation by the state as sovereign of every aspect of each enterprise's behavior would be indistinguishable from regulation by the state as owner.

Thus, the question whether the state regulates *qua* owner or *qua* sovereign is a non-issue. The question whether to micromanage, however, is not. Economic reform policies aim to abolish precisely this detailed regulation by the state. Regulation by enterprise-specific directives, whether called laws or administrative orders, will have to yield to regulation by rules of general applicability. This is because the difference between laws of general application and enterprise-specific directives is that enterprise-specific directives need to be guided and coordinated; they have to be part of a plan. But the government is trying to reduce the scope of the plan; it is trying to enlarge the autonomous powers of management. Prices, interest rates, and other traditional instruments of macroeconomic policy can function as economic levers only when they apply to all enterprises indifferently. High-priced inputs are supposed to go to those enterprises which, because they produce a valuable product, can afford them, not to those that can persuade their supervisory government organ to supply them. Similarly, the task for law in economic reform is to function as an aspect of the environment in which enterprises operate. If all economic law is enterprise-specific and the product of bargaining between the enterprise and superior levels of administration, there is no hope of making its content rational and internally consistent without something like a plan. If law is to be used as an economic lever, it must apply indifferently to large numbers of enterprises. The question is then whether it can be made to do so.

B. Institutions for Making and Enforcing Rules

The key to economic reform is the use of rules of general applicability to replace ad hoc bargaining between individual enterprises and their superiors. These rules require a corresponding set of institutions for promulgation and enforcement. China does have a system apparently intended to play this institutional role, and this Section sets out its formal structure.

1. The State

The National People's Congress (NPC) is constitutionally the supreme sovereign body of the People's Republic of China.[60] Its members are elected by People's Congresses at the provincial level. The National People's Congress elects a Standing Committee which exercises the authority of the NPC when the NPC is not in session. The NPC, upon the recommendation of the Party, elects the State Council, which consists of the Premier, Vice-Premiers, and the heads of central ministries, bureaus, and commissions.

Three levels of government exist below the center.[61] First are the 30 provincial-level governments: twenty-two provinces, five autonomous regions (essentially border provinces largely peopled by non-Han ethnic groups), and the cities of Beijing, Shanghai, and Tianjin, which are treated as provinces directly under the central government. Each provincial-level administrative unit has a People's Congress and a Standing Committee, which stand in roughly the same relation to the provincial-level government as do the NPC and its Standing Committee to the central government. Delegates are elected from county-level People's Congresses.

County-level administrative units consist of approximately 2,300 counties and county-level municipalities.[62] County-level governments, like the governments above them, are appointed by the corresponding People's Congresses, which also have Standing Committees. Delegates to county-level People's Congresses are directly elected.

Below the county-level unit is the township-level unit, which consists of towns (*zhen*), townships (*xiang*), and districts (*qu*). Township-level governments are appointed by township-level People's Congresses, whose members are directly elected. Township-level People's Congresses have no Standing Committee. Both Peo-

60. This summary follows generally that of M. BLECHER, CHINA: POLITICS, ECONOMICS AND SOCIETY 116-117 (1986).

61. Levels of local government are diagrammed in 1 FAXUE ZHISHI TUJIE (Legal Knowledge Explained by Diagrams) 39 (Li Xirong, Zhu Jingzhe & Song Yinqing eds. 1984).

62. *See* ZHONGGUO FALÜ NIANJIAN 1988 (Law Yearbook of China 1988) 531 (1989).

ple's Congresses at various levels and national and regional governments have various law-making powers.[63]

(a) National People's Congress[64]

The NPC has the power to pass or amend the Constitution, basic statutes (*jiben falü*), the economic plan, and the state budget. It also can alter or annul decisions of its Standing Committee.[65] The NPC's Standing Committee has the power to interpret the Constitution; to pass or amend statutes (*falü*) other than those which should be passed by NPC; to supplement or amend NPC statutes, the plan, or the budget when the NPC is not in session; to interpret statutes; to annul administrative rules and regulations, decisions, and orders of the State Council that contravene the Constitution or statutes; and to annul local regulations and decisions where they contravene the Constitution, statutes, or State Council administrative rules and regulations.[66]

(b) State Council[67]

The State Council is considered an administrative, not a legislative, organ. Therefore, its enactments are administrative rules, not laws. Only the NPC or its Standing Committee can actually pass laws. The State Council can pass only administrative regulations (*xingzheng fagui*), decisions, and orders.[68] One practical consequence of this is that courts, according to Chinese administrative law doctrine, have no presumptive power to pass judgment on State Council regulations.[69] However, courts automatically have the

63. For a detailed discussion of the formal structure of lawmaking in China, *see* Keller, *Legislation in the People's Republic of China*, 23 U.B.C.L. REV. 3 (1989), and Hsia & Johnson, *Lawmaking in China* (pts. 1-5), EAST ASIAN EXEC. REPORTS, Jan. 15, 1987, at 6, EAST ASIAN EXEC. REPORTS, Apr. 15, 1987, at 10, EAST ASIAN EXEC. REPORTS, June 15, 1987, at 10, EAST ASIAN EXEC. REPORTS, Aug. 15, 1987, at 9, EAST ASIAN EXEC. REPORTS, Sept. 15, 1987, at 12.

64. The role of the NPC is described in more detail in Keller, *supra* note 63, at 660-69, and Hsia & Johnson, *Lawmaking in China* (pts. 1-5), EAST ASIAN EXEC. REPORTS, Jan. 15, 1987 (pt. 1) at 6.

65. *See* ZHONGHUA RENMIN GONGHEGUO XIANFA (Constitution of the People's Republic of China) [XIANFA], 1982 ZHONGHUA RENMIN GONGHEGUO FAGUI HUIBIAN (Collected Laws and Regulations of the People's Republic of China) [FGHB] 1, *as amended*, 1988 ZHONGHUA RENMIN GONGHEGUO GUOWUYUAN GONGBAO (Bulletin of the State Council of the People's Republic of China) [SC BULLETIN] 359, art. 62.

66. *See* XIANFA, art. 67.

67. For more detail, *See generally* Keller, *supra* note 63, at 669-80; Hsia & Johnson (pt. 2), EAST ASIAN EXEC. REPORTS, Apr. 15, 1987, *supra* note 64, at 10.

68. *See* XIANFA, art. 89.

69. The Administrative Litigation Law provides that courts can hear a specific class of administrative cases as well as any other cases where appeal to a court is provided for by statute or regulation. They may not hear cases where the final decision is stipulated by law to rest with administrative organs. *See Zhonghua renmin gongheguo*

power to hear legal cases.

(c) Local People's Congresses

People's Congresses and their Standing Committees at the provincial level may adopt local rules and regulations (*fagui*).[70] These are valid upon adoption but must be reported to the NPC Standing Committee.[71] People's Congresses and their Standing Committees of capital cities of provinces and autonomous regions and other "relatively large cities" (as designated by the State Council) may also adopt local rules and regulations, but these are valid only upon the approval of the provincial-level People's Congress Standing Committee.[72] Other local People's Congresses have no specific grant of law-making authority, except perhaps in the vague power to ensure the implementation of statutes, policies, and regulations.[73] They can, for example, pass resolutions, but what their force would or should be in a court is not clear.

(d) Local People's Governments

Governments at and above the county (*xian*) level can formulate rules (*guizhang*) in accordance with statutes and State Council administrative rules and regulations (*fagui*).[74] Governments below that level (townships, towns) have no explicit grant of lawmaking power.

2. The Courts

China has a system of courts of general jurisdiction and various specialized courts.[75] The structure of the Chinese government and its relationship to the courts is shown in simplified form in Figure 1. Generally, court presidents are chosen by the People's Congress at the same level, but vice-presidents and other judges are chosen by

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xingzheng susong fa (Administrative Litigation Law of the People's Republic of China), 1989 SC BULLETIN 297, arts. 11, 12.

70. For more detail on local legislation, *see generally* Keller, *supra* note 63, at 680-85; Hsia & Johnson (pt. 2), EAST ASIAN EXEC. REPORTS, Apr. 15, 1987, *supra* note 64, at 10.

71. *See Zhonghua renmin gongheguo difang geji renmin daibiao dahui he difang geji renmin zhengfu zuzhi fa* (Law of the People's Republic of China on the Organization of Local People's Congresses and Local People's Governments at Various Levels), *as amended*, 1986 FGHB 97, art. 7 [hereinafter Local Government Law].

72. *See id.*, art. 7.

73. *See id.*, art. 8.

74. *See id.*, art. 51.

75. The structure of the court system is set out in *Zhonghua renmin gongheguo renmin fayuan zuzhi fa* (Law of the People's Republic of China on the Organization of People's Courts), *as amended*, 1983 FGHB 4 [hereinafter Court Organization Law]. There are about 132 specialized courts, whose jurisdiction is by subject matter and is not limited by administrative boundaries. *See* Chang Hong, *Top Judge Feels Law Has Made Big Gains*, China Daily, Oct. 3, 1989, at 4, col. 1.

the corresponding People's Congress Standing Committee.[76] The exception to this rule is the Intermediate-Level People's Courts (ILPC), where the provincial-level People's Congress Standing Committees usually choose all judges, including the court president. In minority areas, unlike in most provinces, a level of People's Congress may exist between the province and the county. If so, that People's Congress and its Standing Committee choose ILPC personnel according to the same procedure.

Courts of general jurisdiction are divided into four levels. All can serve as courts of original jurisdiction, depending on the perceived importance of the case. Following European and Japanese practice, the Chinese system allows one appeal, with the second hearing a trial de novo. At the top of the structure is the Supreme People's Court (*zuigao renmin fayuan*) (SPC). Below it, at the provincial level, are the thirty Higher-Level People's Courts (*gaoji renmin fayuan*) (HLPC). One HLPC is located in each province, autonomous region (*e.g.*, Tibet or Xinjiang), and centrally-administered city (*e.g.*, Beijing or Shanghai). Below the HLPCs are the 337 Intermediate-Level People's Courts (*zhongji renmin fayuan*) (ILPC),[77] which are established just below the provincial level in prefectures (*diqu*), provincially-administered cities, and within centrally-administered cities. At the bottom are approximately 3,000[78] Basic-Level People's Courts (*jiceng renmin fayuan*) (BLPC), which exist at the county level. Each court has a president, a vice-president, and several judges. Because parties from outlying areas may have difficulties attending court, a BLPC may establish branch courts known as People's Tribunals (*renmin fating*) (PT) outside the town or city in which it is headquartered.[79] The decision of a

76. *But see infra* notes 275-279 and accompanying text.

77. The figure is from Chang Hong, *supra* note 75.

78. A 1989 China Daily article, reporting an interview with Supreme People's Court president Ren Jianxin, put the figure at 2,858. *See* Chang Hong, *supra* note 75. Yet six months earlier in his report to the National People's Congress, Mr. Ren himself put the figure at 3,014. *See* Ren Jianxin, *Zuigao Renmin Fayuan Gongzuo Baogao* (Supreme People's Court Work Report), ZHONGHUA RENMIN GONGHEGUO QUANGUO RENMIN DAIBIAO DAHUI CHANGWU WEIYUANHUI GONGBAO (Bulletin of the Standing Committee of the National People's Congress of the People's Republic of China) [NPCSC BULLETIN], No. 2, 1989, at 109, 122 (report delivered to 2d Session of 7th National People's Congress, Mar. 29, 1989). The latter figure is more likely to be correct.

79. The establishment and functioning of PTs are governed by two regulations. The first, entitled "Experimental Procedures for the Work of People's Tribunals (Draft)" (*renmin fating gongzuo shixing banfa (cao'an)*), was circulated by the Supreme People's Court to lower courts in 1963. The second, entitled "Several Rules Concerning People's Tribunals" (*guanyu renmin fating de ruogan guiding*), was formulated in July, 1988 by the Supreme People's Court and apparently circulated to lower courts. Neither document has to my knowledge been published. *See* Han Shuzhi, *Renmin fating shezhi ji gongzuo de jige wenti* (Several Problems in the Establishment and Work of People's Tribunals), FAXUE (Jurisprudence) (Shanghai), No. 10, 1990, at 18.

PT is the decision of the BLPC and is properly appealed to the court above the BLPC.[80] There are over 17,000 PTs across the country.[81]

China's courts have a staff of 215,000, including 125,000 judges.[82] I have stressed the administrative levels of the courts because court personnel are essentially controlled by the government at the corresponding level.[83] Unlike federal judges in the United States, Chinese judges have no security of tenure and below the SPC are not appointed by the central government. Hence, BLPC judges are beholden to the county-level government, and HLPC judges are beholden to the provincial-level government.[84]

Officials in China's court system are generally poorly educated.[85] China now has some seven "political-legal institutes" and thirty-three law departments which annually produce about 4,000 LL.B. graduates.[86] Because very little legal education took place between the mid-1960s and the late 1970s,[87] qualified persons who can serve as judges are scarce. Recent graduates, in their early twenties, are simply too young.[88] A large number of judges, espe-

80. Court Organization Law, *supra* note 75, art. 20.

81. *See* Ren Jianxin, *supra* note 78, at 121.

82. *See* Chang Hong, *supra* note 75. I have corrected the figure for the total number of courts in light of the figure for basic-level courts given in Ren Jianxin, *supra* note 78, at 121. A total of approximately 3,500 seems more likely than the total of 3,358 given in Chang Hong, *supra* note 75. In his 1988 report to the National People's Congress, then-Supreme People's Court president Zheng Tianxiang gave a figure of 3,435 courts as of the end of 1987. *See* Zheng Tianxiang, *Zuigao renmin fayuan gongzuo baogao* (Supreme People's Court Work Report), Fazhi ribao (Legal System Daily), Apr. 4, 1988, at 2.

83. Officially, the court president is appointed by the People's Congress of the same level as the court; the vice-president and other judges are appointed by the Standing Committee of the same People's Congress. People's Congresses are rarely if ever anything more than rubber stamps for the local Party organization, particularly in matters of legal administration, which are handled by the same Party committee that handles public security matters. *See infra* note 276 and accompanying text.

84. Few ILPCs have a People's Congress at the same level. Prefectures, for example, are units of administration immediately below the provincial government established for the convenience of that government and have no People's Congress of their own. In that case, ILPC judges are officially appointed by the provincial People's Congress. *See supra* notes 76-77 and accompanying text.

85. In 1980 Deng Xiaoping himself lamented the severe shortage of competent judicial officials. *See* Deng Xiaoping, *Muqian de xingshi he renwu* (The Present Situation and Tasks), in DENG XIAOPING WENXUAN 1975-82 (Selected Works of Deng Xiaoping 1975-82) 203, 227 (1983).

86. *See* Kraus, *Legal Education in the People's Republic of China*, 13 SUFFOLK TRANSNAT'L L.J. 75, 85 (1989). The LL.B. is a four-year undergraduate degree in China.

87. *See* Cohen, *Notes on Legal Education in China*, 4 LAWASIA 205 (1973) ("[T]he first thing to understand about legal education in China today is that there isn't any."); *see generally* Gelatt & Snyder, *Legal Education in China: Training for a New Era*, 1 CHINA L. REP. 41, 41-50 (1980).

88. *See* Huang Mingli, *Views on Judicial Reform* (in Chinese), ZHENGFA LUNTAN (Politics and Law Forum), No. 1, 1985, at 71, *translated in* JOINT PUBLICATIONS RE-

cially at the basic court level, are demobilized army officers,[89] and some courts even draft their clerks into service as "substitute judges" (*daili shenpanyuan*) when manpower is short.[90] No career judicial bureaucracy with clear, or even vague, standards of competency has been created, and no objective qualifications for judges have been established.[91] Among Hunan's 8,308[92] judges, for example, only 756 (9.1%) have studied beyond high school. Of these, only 300 (3.6% of the total) specialized in law.[93] Nationwide, one writer asserts that only 10% of all judges and procurators have been educated at or above the college level.[94] Some efforts are being made to train judges on the job. In February 1988, the Supreme People's Court and the State Education Commission established a Training Center for Senior Judges. The first class of 120 court officials graduated in July 1989.[95]

SEARCH SERVICE, CHINA REPORT: POLITICAL, SOCIOLOGICAL AND MILITARY AFFAIRS [JPRS-CPS], Oct. 10, 1985, at 42, 46.

89. These officers are simply assigned to a court whether they are wanted there or not. In 1988, the then-president of the Supreme People's Court asked the National People's Congress to give the courts more power to refuse assignments of unqualified personnel and begged local Party committees, People's Congresses, and governments not to send such people. *See* Zheng Tianxiang, *supra* note 82 at 4.

90. *See* Li Yuming, *Shujiyuan bu neng yi "daili shenpanyuan" shenfen banan* [Clerks Cannot Handle Cases as "Substitute Judges"], FAXUE [Jurisprudence] (Shanghai), No. 11, 1990, at 39.

91. In 1988, Supreme People's Court president Ren Jianxin announced that a Judicial Officers Law (*faguan fa*) was being drafted and that it would establish a unified national standard of qualifications for judges. *See* Su Hongzi & Yu Xinnian, *Fayuan gaige he jianshe shi wancheng shenpan renwu de zhongyao baozheng* (The Building and Reform of Courts Are Important Guarantees of the Fulfillment of Adjudication Tasks), Fazhi ribao (Legal System Daily), July 19, 1988, at 1. (His predecessor had stated the same thing earlier in the year. *See* Zheng Tianxiang, *supra* note 82, at 4.) He repeated this claim in 1989. *See* Ren Jianxin, *supra* note 78, at 119. No draft of this law is publicly available, and it has yet to be enacted.

92. I have deduced this figure from others provided in Hunan sheng gaoji renmin fayuan yanjiushi (Hunan Province Higher-Level People's Court Research Office), *Fayuan xianzhuang yu gaige de sikao* (Thoughts on the Current State of Courts and Their Reform), ZHENGZHI YU FALÜ (Politics and Law), No. 2, 1989, at 48.

93. *See id.*

94. *See* Li Maoguan, *Why "Laws Go Unenforced"*, BEIJING REV., Sept. 11-17, 1989, at 13, 15. In his 1989 report to the National People's Congress, Supreme People's Court president Ren Jianxin stated that 30% of "court cadres" (*fayuan ganbu*) had graduated from institutions of higher education. *See* Ren Jianxin, *supra* note 78, at 119. The term "court cadres" covers more than merely judges (*shenpan renyuan*).

95. At the graduation ceremony, Supreme People's Court president Ren Jianxin noted proudly, but probably inaccurately, that "[n]one of the trainees attending the lectures [had] ever participated in rallies, marches, or classroom boycotts during the period from mid-April to early June . . . ." Chang Hong, *Senior Judges Fresh from Training School*, China Daily, July 12, 1989, at 1. An outline of training efforts in general can be found in Xinhua (New China News Agency), *Zheng Tianxiang on the Work of the Supreme People's Court* (in Chinese), Apr. 19, 1986, *translated in* SWB/FE, May 1, 1986, at C1/1, 5; Ren Jianxin, *Zuigao renmin fayuan gongzuo baogao* (Supreme People's Court Work Report), Fazhi ribao (Legal System Daily), Apr. 11, 1990, at 2, 4

IV. CHARACTERISTICS OF LEGAL RULES

Part III introduced a theory of the meaning and role of law in economic reform as well as the available structure of law making and law enforcement. This Part proposes a way of understanding the significance of particular legal rules. Not all rules intended to influence the behavior of enterprises will be equally effective.[96] A particular legal rule will have a variety of features that make it more or less likely to produce a change in enterprise behavior. This Part hypothesizes the existence of a set of relevant features in order to generate a series of questions. These questions are Janus-faced. On the one hand, the claim that they are the right ones to ask represents a conclusion about law and economic reform in China. On the other hand, they are intended to provide a tool for further understanding.

A. Who Is Supposed to "Obey" the Rule?

1. Who Is the Institutional Addressee?

Understanding whose behavior a rule is intended to modify and what would constitute a violation is crucial in order to assess whether the rule will work. Achieving this understanding is not as easy as it might seem. For example, take a common-law tort rule expressed in the following form: "If X causes injury to Y through X's negligence, Y has the right to compensation from X." X does not "violate" this rule by negligently injuring Y; he merely makes himself liable to a judgment in favor of X. The institutional addressee of this rule is a court, which is the only body in common-law jurisdictions ultimately capable of enforcing its consequences.

In China, on the other hand, a rule granting X a "right" to do something is often a command to X's superior to allow X to do the thing in question. The institutional addressee is an administrative body, not a court. The command can be obeyed or disobeyed. What X's remedies are when the superior does not allow the behavior is another question entirely.

(report delivered to 3d Session of 7th National People's Congress, March 29, 1990); Ren Jianxin, *supra* note 78, at 119; Zheng Tianxiang, *supra* note 82, at 2.

96. We certainly cannot take it for granted that mere promulgation by a government body guarantees implementation. A recent article estimated that only 20% of China's laws were properly implemented. *See* Zhao Zhenjiang, Zhou Wangsheng, Zhang Qi, Qi Haibin & Wang Chenguang, *Lun falü shixiao* [On the Effectiveness of Laws], ZHONG-WAI FAXUE [Chinese and Foreign Legal Studies], No. 2, 1989, at 1 [hereinafter Effectiveness of Laws]. No source was given for this figure, and the lack of further explanation makes it almost meaningless. It does suggest a perception by the writers that there exists a serious gap between law on the books and law in practice.

2. Is the Rule Inner-Directed or Outer-Directed?

Is the rule intended to regulate the behavior of governmental actors or is it intended to regulate the behavior of actors external to the government? Because the government is not a unitary entity, this question is really whether the rule is simply intended to publicize a change in organizational procedure on the part of the promulgating body, or whether it is intended to change the behavior of some body not subject to the immediate control of the promulgator. In other words, might it need sanctions beyond internal disciplinary ones — legal, economic, or social sanctions — for implementation?

This question is important because much of China's "legislation" is better understood as the publication of the internal operating procedures of various bureaucracies.[97] A bureaucratic action may consist simply of higher levels telling lower levels what to do. The Chairman of the Federal Reserve Bank can decide that interest rates should be higher. He sends appropriate instructions in written form to lower levels, and lower level bureaucrats, in this particular case, certainly will not refuse to take the necessary implementing actions.

When an administrative bureaucracy is telling an outside party what to do, as when the state prohibits theft, proper implementation will generally require a mechanism for the detection of violations and the imposition of sanctions. The distinction between inner- and outer-directed rules is mentioned not because it is unique to China, but because it is often difficult to draw and because the form of the rule may not offer any useful clues.[98]

Whether a rule affecting Chinese state-owned enterprises is inner-directed or outer-directed is often a matter of degree. When faced with orders issued by their department in charge (DIC),[99] enterprises are more like insiders than outsiders.[100] When faced with

97. This is why the complaint that much of China's law is secret often misses the point, and why the announcement in 1988 that henceforth all of China's laws would be public was so clearly impossible. *See* Kristof, *What's the Law in China? It's No Secret (Finally)*, N.Y. Times, Nov. 20, 1988, at 11, col. 4. Some bureaucratic procedures — a police drug courier profile, the tax bureau's standards for triggering an audit, the minimum land-use fee from a joint venture that a Chinese negotiator is empowered to settle for — *ought* to be secret.

98. See the discussion of types of rules and promulgating authorities in the text accompanying *infra* notes 105-107.

99. Every state-owned enterprise has an administratively superior government department in charge of it (*zhuguan bumen*). The DIC is the agency that in practice exercises the state's "ownership" of the enterprise. For most state-owned enterprises, the DIC is an arm of the local government, not the central government.

100. Such an order is similar to an instruction given by enterprise management to a workshop. The history and structure of state-owned enterprises in China makes it difficult to draw a distinct boundary line separating the enterprise from its DIC. See the discussion on *infra* notes 314-317 and accompanying text.

orders issued by the State Council, however, they are more like outsiders than insiders. Such orders, therefore, require some kind of enforcement mechanism, and each outer-directed rule needs to be examined for an effective enforcement mechanism.

3. Is the Rule Directed at an Individual or a Collectivity?

All other things (such as costs of detection of violations and enforcement) being equal, a rule directed at individuals is more likely to be effective in influencing enterprise behavior than a rule directed at a collectivity such as the enterprise itself. A rule that attempts to set up a system of incentives and disincentives for an organization such as an enterprise may not work because it anthropomorphizes the enterprise and assumes that it acts rationally. In fact, enterprises can act only through human agents, and, as the vast literature on agency costs makes clear, the interests of those agents will not be identical to the interests of the enterprise.

Enterprises behave in certain ways because enterprise managers and decision-makers behave in certain ways. The difficulty of changing organizational behavior by sanctions on the organization itself has been extensively studied in American corporate law literature.[101] Much of the Chinese literature on enterprise incentives is flawed by the assumption that the enterprise is an independent, willing subject of interests.[102] For example, economists frequently claim that enterprises are unproductive because "they" lack any incentive to produce, not having any claim to "their" own profits.[103] This argument proves too much. Corporations in Western economies can also have "their" profits taken away any time the board of directors chooses to declare a dividend, and yet in many ways they do not behave like Chinese enterprises. The difference is due to the fact that Western managers and decision makers, as individuals, face a different set of incentives than their Chinese counterparts.

A rule might be designed, for example, to permit enterprises to

101. *See, e.g.*, C. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR (1975); Coffee, *"No Soul to Damn, No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386 (1981). For further details on how the organizational structure of corporations leads to the effective evasion of liability, *see* Siciliano, *Corporate Behavior and the Social Efficiency of Tort Law*, 85 MICH. L. REV. 1820, 1843-1846 and Stone, *Corporate Social Responsibility: What It Might Mean, If It Were Really to Matter*, 71 IOWA L. REV. 557, 562 (1986).

102. For an exception, *see* Zhang Zhanxin, Zhang Wenzhong & Li Fei, *Gongmin benwei lun* (On the Citizen as the Standard), JINGJI YANJIU (Studies in Economics), No. 7, 1989, at 45, 48.

103. This misconception is not limited to Chinese writers. Professor Ronald I. McKinnon of Stanford University makes the same claim respecting East European enterprises: "Why should managers strive to economize if 100% of the 'profits' are expropriated?" *See* McKinnon, *Can the Soviet Economy Be Saved? Maybe — with Tax Reform*, Wall St. J., Dec. 7, 1989, at A16.

retain an extra ten percent of the profits from investments in specified sectors. Whether this actually leads to more investment in the desired areas (for example, gadgets) depends on who actually benefits from the extra retained profit and who loses from the shift of investment out of non-favored areas. Take the following simplified set of assumptions for a Chinese enterprise:

(1) It is currently producing widgets, a popular consumer item, and makes them available to employees[104] at favorable prices without the need to wait six months;

(2) If it stopped producing widgets in favor of gadgets, the effect of the rule would be to increase its total retained profits;

(3) State accounting rules allow only a small portion of retained profits to be converted to cash for employees while the rest is earmarked for reinvestment or employee housing;

(4) The payoff period for the funds reinvested or spent on housing — that is, the period over which employees receive concrete benefits in the form of increased wages or subsidized housing — extends well beyond the period of employment of current employees.

Where the above assumptions hold true, the extra retained profits, as far as the employees are concerned, are just numbers in a ledger. They have no incentive to change their own behavior, and hence the enterprise's behavior will not change. Rules aimed at changing enterprise behavior, therefore, should be analyzed with the understanding that incentives and disincentives directed at the enterprise as such will be translated into incentives and disincentives to the human agents of the enterprise only, if at all, in an indirect and complex way.

B. Who Promulgated the Rule and How Authoritative Is It?

Rules can be promulgated by a wide variety of agents: the National People's Congress, the Party Central Committee, and the State Council and its ministries, to name a few on the central level; as well as provincial governments and People's Congresses; local governments and People's Congresses; and mass organizations such as trade unions. The rules they promulgate have corresponding degrees of authority, although the Chinese legal system has yet to come up with a definitive hierarchy that would enable rules to be ranked according to such features as label (for example, "law," "regulation," "executive order," or "resolution") and promulgating body.[105] Regulations issued by the State Council or one of its ministries may be given greater weight than laws issued by the NPC

104. In "employees" I include management-level employees who exercise influence over enterprise behavior.

105. *See generally* Keller, *supra* note 63; Hsia & Johnson (pts. 1-5), *supra* note 64.

because the latter are often vague statements of general principle that explicitly contemplate subsequent implementing rules.[106] Indeed, ostensibly lower-order rules often precede the higher-order rules that formally legitimate them because the lower-order rules are seen as trial runs for a new policy.[107]

1. Vertical Position: How High Up Is the Promulgator?

To assume that the higher the level of the law-promulgating authority, the more authoritative and comprehensive the rule, is tempting. The added authority of the rule, however, can be offset by added bureaucratic distance from the ultimate object of regulation. The higher the level of government, the more outer-directed the rules directly regulating enterprises tend to be. Higher levels of government can, of course, promulgate effective inner-directed rules, an increase in central bank interest rates being one example. But the ultimate effectiveness of such inner-directed rules depends upon the existence of large numbers of economic actors organized such that they respond in the desired way to macroeconomic regulation. Unfortunately, because of the soft budget constraint,[108] Chinese state-owned enterprises do not always respond as desired.[109]

106. Compare, for example, *The Law on Sino-Foreign Joint Ventures*, 1979 FGHB 125, a brief 15-article document promulgated by the NPC in 1979, with *Implementing Regulations for the Law on Sino-Foreign Joint Ventures*, 1983 FGHB 276, a 118-article document issued four years later by the State Council.

107. An excellent example is regulations permitting commercial land leasing. This was generally considered forbidden under Article 10 of the 1982 Constitution, which provided that "[n]o organization or individual may appropriate, buy, sell, or lease land or otherwise engage in the transfer of land by unlawful means." As reform progressed, however, many economists and policy-makers realized that there ought to be some legitimate way for state organs to earn money by allowing others to use land under their control. Because, *inter alia*, of the antipathy of senior leaders to the Chinese word "lease" (*zu*) (the same character is used in *zujie*, the humiliating foreign concessions where the writ of pre-1949 Chinese governments did not run), scholars and policy makers came up with "compensated transfer of land use rights" (*tudi shiyongquan youchang zhuanrang*). Article 10 was duly amended to allow the "transfer of land use rights" on April 12, 1988. *See Zhonghua renmin gongheguo xianfa xiuzheng an* (Act Amending the Constitution of the People's Republic of China), 1988 SC BULLETIN 359. This amendment represented merely the seal of approval on an activity that had been going on, in name as well as substance, for some time. On November 29 of the previous year, for example, Shanghai had promulgated a set of regulations on land leasing. *See Measures of Shanghai Municipality on Paid Transfer of the Right of Use of Land* (pts. 1-4), China Econ. News, Jan. 25, 1988, at 8, China Econ. News, Feb. 1, 1988, at 8, China Econ. News, Feb. 8, 1988, at 9, China Econ. News, Feb. 15, 1988, at 9. These regulations in turn merely ratified an existing practice, according to informed Chinese whom I interviewed in Shanghai in August, 1989.

108. See the discussion *supra* notes 24-34 and accompanying text.

109. Suppose, for example, that the government wishes to cut back on investment. It is relatively simple for the government to implement a decision to raise interest rates, thereby increasing the cost of capital. Central bankers make the decision and instruct their subordinates to implement it. This is fairly (but not completely) unproblematic. Enterprises all across the country will actually pay more for capital. They will not

Therefore, the only reliable way to regulate them is through outer-directed regulation: making them do directly what they cannot be made to do indirectly.[110] Unfortunately, enforcement mechanisms for outer-directed rules are often weak. Thus, while higher vertical position should in theory give more force to a rule, the distance from the promulgator to the object often saps its strength.

2. Horizontal Position: Is There Nominal or Actual Jurisdiction?

(a) Bureaucratic

For the purposes of this question, the three relevant enforcement mechanisms are: (1) internal bureaucratic discipline (do what I say or I'll fire or demote you); (2) bargaining power (do what I say or I'll withhold something you need from me); and (3) legal power (do what I say or I'll have a court or some other enforcement agency make you do it). If the actor to be regulated is not in the same bureaucratic system (*xitong*)[111] as the regulator, enforcement of any rule will be difficult. By hypothesis, the regulator lacks direct authority to dictate to the regulated party (mechanism (1)), and as I will argue later, enforcement by courts (mechanism (3)) is often an unrealistic option. The regulator must then rely on the threat of withholding needed resources.[112] The success of this strategy depends on the resourcefulness of the regulated party. Thus, such a regulation cannot be enforced with consistency and loses its rule-like nature.

(b) Territorial

The power and authority of local governments to make rules that apply to persons and organizations from other jurisdictions is unclear. The experimental bankruptcy regulations of Shenyang (the "Trial Rules"), for example, purport to allow cancellation of the debts of bankrupt Shenyang collectives, with no exception made for non-Shenyang creditors.[113] The legal basis for the Trial Rules is not

necessarily invest less, however. If increased capital costs mean a corresponding increase in subsidies for the enterprise or (the equivalent) a decrease in the amount it is required to turn over in taxes and profits, then we can expect no effect on investment.

110. Kornai, for example, notes that socialist governments use price-wage policies, not monetary and fiscal policies, to restrain inflationary tendencies generated within the firm by the lack of a hard budget constraint. *See* J. KORNAI, *supra* note 25, at 374.

111. The notion of bureaucratic "system" (*xitong*) is explained in K. LIEBERTHAL & M. OKSENBERG, *supra* note 47, at 141-42. In essence, it refers to a vertical functional hierarchy. Each system represents a separate line of authority, and only at the State Council level do all lines of authority come together.

112. Included in this strategy are considerations of reciprocity. If two *xitong* have frequent dealings with each other, they will tend to cooperate. *See id.* at 142.

113. *Shenyang shi guanyu chengshi jiti suoyouzhi gongye qiye pochan daobi chuli de shixing guiding* (Shenyang City Trial Rules Concerning the Handling of the Bankruptcy

entirely clear. Shenyang has been granted a high degree of economic management power and, like other favored cities, is listed separately in the state economic plan.[114] But this economic power is not necessarily the same thing as legislative power, as Chinese commentators themselves have noted.[115] The question of legislative competence is of more than theoretical interest. Article 10 of the Shenyang Trial Rules, for example, purports to discharge all debts remaining unpaid after distribution of the assets of a bankrupt enterprise. But from where does the Shenyang municipal government get the authority to nullify unilaterally the rights of creditors from outside Shenyang? There was no specific grant of statutory authority from the center, and no body of law specifically addresses the question of cross-jurisdictional enforcement of law and judgments, because China does not admit the principle of federalism.[116]

As a practical matter, Shenyang probably does have the authority to discharge debts owed to non-Shenyang creditors. But this authority does not come from formal legislative delegation. Instead, this power comes from the role Shenyang has been selected to play as a laboratory of economic reform. The Trial Rules could not have been formulated and promulgated without the approval of the central government, and this gives them the kind of nationwide validity they need to be able to provide for the discharge of debts owed to non-Shenyang creditors.[117] Indeed, since the passage of the na-

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and Closing of Urban Industrial Enterprises Under Collective Ownership), *reprinted in* ZHONGGUO QIYEJIA (The Chinese Enterprise Manager), No. 1, 1986, at 55. "Trial" is the standard translation of *shixing*, although here "experimental" might be less ambiguous.

114. Since February 1983, the Chinese government has granted provincial-level economic management power to several cities, including Shenyang, thus giving them the power to implement certain far-reaching reforms. This means that for purposes of economic planning, Shenyang is treated as a province and not merely as a city within a province. To understand the budgetary consequences of this, consider the difference between a law school as a separate university faculty and a law department within the faculty of arts and sciences.

115. *See* Tian Jia, Zhu Limin & Cao Siyuan, *Separately Listing Cities in the State Plan: Contradictions and Suggestions* (in Chinese), Shijie jingji daobao (World Economic Herald), Oct. 26, 1987, *translated in* SWB/FE, Nov. 18, 1987, at B2/5, 8 ("We propose that the N[ational] P[eople's] C[ongress] Standing Committee amend the 'Organic Law of Local People's Congresses at All Levels and Local People's Governments at All Levels,' so that people's congresses and their standing committees of separately-listed cities may enact local laws and regulations under the prerequisite that they do not conflict with the constitution, law, administrative law and regulations, and local laws and regulations of autonomous regions.").

116. To remedy this problem, sub-central jurisdictions have begun to conclude what are essentially treaties of mutual protection and respect. *See infra* note 314 and accompanying text.

117. The drafters may not have worried about this problem simply because the Shenyang Trial Rules apply only to collectively-owned enterprises, which are unlikely to have non-local creditors. This may not be so in the future, however.

tional bankruptcy law[118] in December of 1986, the Chinese press has written of the Trial Rules as the local, experimental implementation of the national law, implying that the contents are the same.[119] While these claims are not correct,[120] they demonstrate the widespread belief that what was being implemented in Shenyang was a national law of national validity.

C. Who Is to Enforce the Rule and How?

The question of who will enforce legal rules, and how such enforcement will be effectuated, is crucial. Because different actors have different resources, the question of how depends on the question of who, and thus both must be treated together.

1. Disinterested or Interest-Driven Enforcement?

When a legal norm is violated, some party may stand to benefit from its enforcement. That party may not, however, have standing to seek enforcement. When a disinterested official has the power to initiate enforcement proceedings, several factors may stay her hand: lack of personal benefit, budget insufficiencies, and fear of retaliation. However, when some person stands to gain from taking enforcement actions, that person is more likely to actively seek enforcement of the legal norm. Thus, in looking at any norm, we should ask whether it offers some incentive to anyone to bring enforcement proceedings, or whether such proceedings are entirely in the hands of disinterested officials. Disinterested enforcement can be centralized or decentralized, depending on the level of officialdom with the enforcement power. Interest-driven enforcement is always decentralized.

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118. *Zhonghua renmin gongheguo qiye pochan fa (shixing)* (Enterprise Bankruptcy Law of the People's Republic of China (for Trial Implementation)), 1986 FGHB 58, *translated in* FBIS, Dec. 5, 1986, at K1 [hereinafter EBL or Bankruptcy Law].

119. *See Dismissed Workers Helped*, China Daily, Dec. 9, 1986, at 3, col. 3 ("Before official publication of the law, the State had tried out the law in some enterprises in several cities, including Shenyang Explosion [Prevention] Equipment Factory . . . ."); *Bankruptcy Law's Trial Extended*, China Daily, Nov. 7, 1987, at 1, col. 1 ("The trial implementation scheme for China's first bankruptcy law has been extended to 28 enterprises in six cities . . . . Passed last December by the National People's Congress, the Trial Bankruptcy Law has been tried out only on selected enterprises . . . ."). In fact, the Bankruptcy Law did not come into effect even for the purposes of trial implementation until November 1, 1988.

120. The local regulations implemented in Shenyang, for example (the Trial Rules), were promulgated in February, 1985 — long before the passage of the national Bankruptcy Law. *See Shenyang sanjia gongchang pochan ji (xia)* (Account of the Bankruptcy of the Three Shenyang Factories (Part III)), Ming po (Hong Kong), May 30, 1986, at 42. The national law was in nothing like its final form at that time. For a detailed legislative history of the national law, *see* Chang, *The Making of the Chinese Bankruptcy Law: A Study of the Chinese Legislative Process*, 28 HARV. INT'L L.J. 333 (1987).

2. Which Institution, If Any, Is in Charge of Enforcement?

Regulations in China typically are consigned to some bureaucracy for enforcement. The prospects for successful enforcement depend on the power of the bureaucracy that "owns" the law. Thus, public security regulations can be enforced effectively,[121] while environmental protection and land use regulations are often ignored.[122] The enforcing bureaucracy may have power over some violators, such as private citizens, but not over others, such as other bureaucratic units.[123]

Surprisingly enough, some regulations are intended to be enforced by the regulated parties themselves. For example, in the course of a campaign to eliminate financial misconduct in taxing and pricing, one of the key methods proposed was for departments and enterprises to "continue to check their own financial affairs. . . . Those regions, departments and enterprises that have not checked thoroughly their financial affairs must recheck them seriously and guard against perfunctoriness."[124] This strategy is nothing but a pious hope and a confession that no genuinely effective enforcement mechanism exists.[125]

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121. One group of writers states that criminal laws are "comparatively well implemented" compared, for example, with State Council administrative regulations and local laws. *See* Effectiveness of Laws, *supra* note 96, at 1.

122. Regarding environmental law, *see* Jin Ping, *Huan-bao fa zai zhixing zhong geqian* [Implementation of the Environmental Protection Law Has Reached an Impasse], FAZHI JIANSHE [Construction of the Legal System], No. 2 (1989), at 8. Regarding land use regulations, *see Violators of Land Law Could Land Up in Jail*, China Daily, Mar. 23, 1989, at 1, which reports a statement by an official of the State Land Administration Bureau that the 1987 Land Administration Law had done nothing to stop the illegal occupation and trading of farmland.

123. "[L]aw violators are often organs, businesses, or institutions of the State, who simply choose to ignore any punishment meted out by administrative departments. Since these administrative departments have no compulsory power to cope with such violators, they are often forced to turn a blind eye to breaches of law." *More Muscle Waged [sic] in Enforcing Laws*, China Daily, Oct. 3, 1985, at 2, col. 2.

124. Xinhua (New China News Agency), *Patchy Results of Financial Inspections Lead to Further Demands* (in Chinese), *translated in* SWB/FE, Nov. 13, 1985, at BII/6, 7.

125. The reader may object that this practice is not very different from self-reporting of income under the income tax laws or self-regulation by professional bodies such as doctors and lawyers in the United States. There are two answers to this objection. First, to say that self-regulation is ineffective in China is not to imply that it is unusually effective in the United States. *See, e.g.*, Derbyshire, *How Effective Is Medical Self-Regulation?*, 7 LAW & HUMAN BEHAVIOR 193 (1983) (doctors); Walters, *Self-Regulation Doesn't Work*, L.A. Daily J., Apr. 10, 1985, at 4 (lawyers). Self-regulation is difficult to justify except on the grounds that only professionals possess the specialized knowledge required to make regulation fair and effective. *See* S. USPRICH, THE THEORY AND PRACTICE OF SELF-REGULATION 17, 26 (1974) (discussing the "expertise rationale"). One could plausibly argue that the financial affairs of enterprises are so complex that only those with an intimate knowledge of the enterprise can figure them out. Even if

While this Article cannot examine all possible enforcement institutions, two ought to be distinguished from the rest.

(a) The Communist Party

Many regulations cannot be enforced through the action of state institutions alone; the Party organization is required to act as well. For example, the promulgation of the Forest Law[126] in 1984 did nothing to stop the indiscriminate clear cutting of forests. Such cutting abated only after the Party Central Committee sent work teams to the affected areas and the CCP Central Discipline Inspection Commission issued warnings.[127] Whether the Party is likely to assist in enforcement of a law cannot be predicted from the subject matter of the law alone. A better indication of close Party involvement is joint promulgation by a state organ and a Party organ.[128]

(b) The Court System

Although the court system functions in many ways like other bureaucracies, it deserves separate treatment because of its fundamentally different mission. Courts have the putative authority to issue orders cutting across bureaucratic and territorial boundaries. A judge sitting in a Hunan county and appointed by the county People's Congress could, under proper circumstances, legitimately order a state-owned, city-run handicrafts factory in Harbin to pay a sum of money to a collectively-owned, township-run sandalwood supplier in Guangxi. No other institution in China, including the Communist Party, has this kind of formal authority. Thus court enforcement of rules has the potential to provide a much greater degree of uniformity and consistency than enforcement by other bureaucracies, provided the courts actually can command obedience and have a system for ensuring consistent enforcement. The re-

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self-regulation is the only possible method of regulation, however, it does not come without a cost.

Second, members of self-regulated bodies in the United States are still ultimately answerable to courts. Doctors and lawyers can be sued for malpractice. Doctors as a group have some incentive to bar incompetent ones from practice because the cost of mistakes is reflected in increased malpractice insurance premiums. Contrary to what is commonly assumed, *see, e.g.*, Schepers, *Preventing Malpractice: Professional Self-Regulation and the Quality of Care in Anesthesiology*, 3 NOTRE DAME J. L. ETHICS & PUB. POL'Y 249 (1988), only part of that cost can be passed on to patients because the demand for medical services is not perfectly inelastic.

126. *Zhonghua renmin gongheguo senlin fa* [Forest Law of the People's Republic of China], 1984 FGHB 413.

127. *See More Muscle Waged [sic] in Enforcing Laws*, China Daily, Oct. 3, 1985, at 2, col. 2.

128. *See, e.g., Quanmin suoyouzhi gongye qiye changzhang gongzuo tiaoli* [Regulations on the Work of Directors of Industrial Enterprises Owned by the Whole People], 1986 FGHB 583 [hereinafter 1986 Director Regulations] (issued jointly by Chinese Communist Party Central Committee and State Council).

markable breadth of the formal authority of courts, however, merely underscores its purely formal character. The enforcement of rules through the court system is often difficult.

D. Can the Rule Really Be Enforced?

The question of whether a given rule can be enforced effectively clearly is relevant to this Article's analysis. Some understanding of the society in which the rule is to operate is necessary for an answer, however.

1. Are the Consequences of Violating the Rule Clear and Knowable?

Many rules are not really intended to be strictly implemented. Because they are merely hortatory, violation of the rules may result in no consequences of importance. The Constitution is an excellent example. That the act of some governmental body may have been in violation of the Constitution is not an argument against the act's legal validity. The courts do not have power to base decisions on constitutional provisions, and constitutional rights are not protected except by statute.[129]

Another example is the provision of the Court Organization

129. Guo Linmao in *Lun woguo xianfa shishi de xianzhuang he duice* [On the Current State of Implementation of China's Constitution and Countermeasures], FAZHI JIANSHE [Construction of the Legal System], No. 3 (1989), at 19 (notes that no state laws have ever been declared unconstitutional, and provides examples of what he believes to be unconstitutional legislation).

The State Council's May 20 1989, declaration of martial law in "certain parts" of Beijing, *see Guowuyuan guanyu zai beijing shi bufen diqu shixing jieyan de mingling* [State Council Order on the Implementation of Martial Law in Some Districts of Beijing Municipality], 1989 SC BULLETIN 392, presents an interesting problem. Only the Standing Committee of the National People's Congress has the power to impose martial law over the entire city of Beijing. *See* XIANFA [Constitution] art. 67. Technically, however, the State Council was acting within its powers provided one square inch of Beijing was left uncovered. *See id.*, art. 89 (granting the State Council the power to decide to impose martial law in parts of provinces, autonomous regions, and directly-administered cities such as Beijing). Some commentators have complained that those behind the proclamation (it is difficult to speak of a monolithic "government" here) violated the spirit of the Constitution by using the authority of the State Council when there was time to seek Standing Committee approval. *See, e.g.*, Cohen, *Law and Leadership in China*, FAR EASTERN ECON. REV., July 13, 1989, at 23. Still, none of Beijing's rural counties, which constitute the greater part of the municipality geographically, was formally subject to martial law.

One technicality goes the other way: while the State Council may have had the power to *decide* to impose martial law, only the President may actually proclaim [*fabu*] it. *See* XIANFA art. 68. Since it is Premier Li Peng's signature, and not that of President Yang Shangkun, that appears on the document proclaiming martial law, it is technically no more valid than a bill passed by Parliament but unsigned by the Queen. The point of this discussion is merely to note that no court in China exists where either of these arguments will be made, or if made, seriously listened to.

Law mandating public trials.[130] Years after its promulgation, articles still appear frequently in the press describing how *more* trials are being opened to the public, with little apparent concern for continuing illegality of the substantial number of trials that are still not open.[131] The point is that the failure of a court to conduct an open trial would not necessarily be seen as a violation of Article 7 of the

130. "Trials of cases by people's courts, with the exception of those involving state secrets, matters of personal privacy, and crimes by minors, shall uniformly (*yilü*) be carried out in public." Court Organization Law, *supra* note 75, art. 7.

131. In his 1990 report to the National People's Congress, Ren Jianxin, the president of the Supreme People's Court, denounced foreign reports of secret trials as "deliberate fabrications" and "vicious slanders" on China's judicial system. *See* Ren Jianxin, *supra* note 95, at 2; Tyson, *China Dismisses Charges That Courts Violate Rights*, Christian Science Monitor, Mar. 30, 1990, at 4.

In fact, Mr. Ren need not have looked abroad to find "vicious slanders" on China's judicial system. Some Chinese sources openly complain about the lack of public trials. *See, e.g.*, Qi Lirong, *Gongkai shenpan de sikao* [*Thoughts on Public Trials*], FAZHI JIANSHE [Construction of the Legal System], No. 3 (1989), at 16. Others merely note the phenomenon but do not seem terribly concerned. *See, e.g.*, Jiang De & Zhou Yemao, *Ying gongkai de yi-shen quanbu gongkai* [All Trials of First Instance That Should Be Open to the Public Are Open Open to the Public], Fazhi ribao [Legal System Daily], Feb. 24, 1989, at 1 (reporting that in one city, all first-instance cases that should have been publicly tried were so tried, and that "a portion" [*bufen*] of second-instance cases were publicly tried); Su Hongzi & Yu Xinnian, *supra* note 91, at 1 (reporting the call of Supreme People's Court president Ren Jianxin for all first-instance trials and "as many [second-instance trials] as possible" to be public, subject to statutory exceptions); Xinhua (New China News Agency), Work Report of Supreme People's Court to NPC (in Chinese), *translated in* FBIS, Apr. 25, 1985, at K2, K4, K5 (implying that only typical cases with propaganda value are to be tried publicly).

In the same report in which he denounced foreign reports of secret trials, Ren admitted that "practical problems" still existed in making trials open to the public, among them the fact that "some" courts simply lacked courtrooms in which to hold the trials. *See* Ren Jianxin, *supra* note 95, at 2. Ren's own predecessor at the Court stated that in 1983, only 20% of local courts had a courtroom for trials. By 1987, this figure had risen to one half. *See* Zheng Tianxiang, *supra* note 82, at 2. As of 1989, only 17 of Shaanxi province's 118 courts had courtrooms for trials. *See Shaanxi geji shenpan fating jiang zai wunian nei jiancheng* [Trial Courtrooms at All Levels Will Be Completed Within Five Years in Shaanxi Province], Fazhi ribao [Legal System Daily], Apr. 19, 1989, at 1.

During Ren's own tenure, the Supreme People's Court issued a notice pointing out that the Criminal Procedure Law required courts to try publicly cases on retrial, but allowing them not to do so where "the conditions were not yet present." *Zuigao renmin fayuan, zuigao renmin jianchayuan guanyu gongkai shenli zaishen anjian de tongzhi* [Supreme People's Court and Supreme People's Procuracy Notice on Publicly Adjudicating Cases on Retrial], Apr. 30, 1988, in ZHONGHUA RENMIN GONGHEGUO FALÜ QUANSHU [Compendium of the Laws of the People's Republic of China] 297 (1989).

The attitude of the Supreme People's Court is perhaps expressed best in a document issued during the height of the 1983 anti-crime campaign, when lower courts were asking to dispense with public trials in order to get on with the business of convicting criminals. The Court issued an instruction noting that while public trials were required by law, the *degree* of "publicness" could be "flexibly determined in accordance with the actual situation." *Zuigao renmin fayuan guanyu renmin fayuan shenpan yanzhong xingshi fanzui anjian zhong juti yingyong falü de ruogan wenti de dafu* [Supreme People's Court Reply Concerning Several Questions on the Concrete Application of Law by People's Courts in the Adjudication and Judgment of Serious Criminal Cases], Sept. 20,

Court Organization Law provided the court was doing the best it could. In other cases, a law may be promulgated largely for cosmetic purposes. When push comes to shove, as in the political crisis of May and June, 1989, the leadership can show "little more . . . concern for the government's rules of procedure than the party's."[132]

2. Is the Rule Specific Enough to Be Enforceable?

Some rules are quite concrete. For example, Article 3 of the Economic Contract Law[133] states that "[e]conomic contracts, except for those in which accounts are settled immediately, shall be in written form." Other rules provide standards that are not bright lines but nevertheless dictate the terms of legal argument and provide a means for distinguishing legitimate arguments from illegitimate ones. Article 3 of the Bankruptcy Law, for example, applies the Bankruptcy Law to enterprises that have suffered losses *due to poor management.*[134] This sort of rule requires argumentation to apply, but certain arguments — those that concede poor management — are ruled out of bounds. Finally, some rules do not even provide the vaguest kind of standards and can hardly be called rules at all. Nevertheless, their formulators seem to think of them as such. A document issued in 1987 by the Shanghai government, for example, stipulated that the enterprise director had the duty to "correctly handle the interests of the state, the enterprise, and the staff and workers."[135] This sort of "rule" cannot be implemented without any guidance as to what constitutes correct handling. A survey of a large amount of legal literature has failed to reveal even a hint of an answer, however vague, to this question.

1983, Question 12, in ZHONGHUA RENMIN GONGHEGUO FALÜ QUANSHU [Compendium of the Laws of the People's Republic of China] 123, 126 (1986).

For complaints that Chinese courts decide cases in advance of the trial, which is a mere formality, see the sources cited in note 266 *infra*.

132. Cohen, *supra* note 129, at 24; *see also* Alford, *"Seek Truth from Facts" — Especially When They Are Unpleasant: America's Understanding of China's Efforts at Law Reform*, 8 UCLA PAC. BASIN L.J. 177, 179-184 (1990). Of course, China's leaders are not necessarily unregenerate cynics. They may be susceptible to the cosmetic appeal of the law as well, provided it does not get in the way of what needs to be done.

133. *Zhonghua renmin gongheguo jingji hetong fa* [Economic Contract Law of the People's Republic of China], 1981 FGHB 1.

134. *Supra* note 118 (emphasis added). The Bankruptcy Law is discussed more fully in Section V., Part C, *infra*.

135. Shanghai shi jiaqiang qiye guanli lingdao xiaozu bangongshi [Office of the Leading Group of Shanghai Municipality for Strengthening Enterprise Administration], *Guanyu shishi sange tiaoli zhong ruogan juti wenti de chuli yijian* [Suggestions for Handling Several Concrete Problems in the Implementation of the Three Regulations], *reprinted in* GONGYE QIYE GUANLI [Industrial Enterprise Management], No. 2 (1987), at 81 [hereinafter Shanghai Leading Group].

3. Does the Rule Take Account of Actual Social Conditions?

Some rules issued by government authorities are dead letters right from the start because they fail to take account of Chinese social reality. The body charged with their application must therefore reinterpret the rules if they are to have any effect at all. For example, Article 29 of the *Regulations on the Work of Directors in Industrial Enterprises Owned by the Whole People*[136] states: "The factory director has the right to refuse the transfer or borrowing of enterprise personnel by any organization or individual external to the enterprise." This rule is inconsistent with reality. State-owned enterprises cannot freely hire and fire workers, and the workers cannot generally choose their own jobs or resign at will.[137] Nevertheless, factory directors, whatever their prerogatives, do not own enterprise personnel outright. The rule has therefore been reinterpreted to forbid only improper frequent transfers of personnel or long-term borrowing without compensation. The department in charge of the enterprise may still promote or transfer cadres or other workers if proper procedures are followed.[138]

V. EFFECTIVENESS OF PARTICULAR RULES: THREE CASE STUDIES

The regulation of the activities of state-owned enterprises is vital to the success of economic reform policies. As noted above, a key aspect of reform policy is the devolution of decision making power to the level of the enterprise. This devolution will be pointless and even counterproductive, however, if the enterprise management does not make appropriate decisions. On the one hand, then, certain laws aim to make enterprises and their managers accountable for their decisions. On the other hand, other laws attempt to increase the independence of enterprise managers, thus making it more justifiable to hold them accountable. In this Part, I will look at examples of particular rules that attempt to guide enterprise behavior and discuss their effectiveness.

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136. 1986 Director Regulations, *supra* note 128.

137. *See* Zhang Jixun, *Labor Management in Foreign Affiliates*, JETRO CHINA NEWSLETTER, Mar.-Apr. 1990, at 15.

138. *See* Shanghai Leading Group, *supra* note 135, at 83-84. A concrete example is that of Xie Chunsheng, an employee of a Beijing factory who was offered a job with a Sino-foreign joint venture. Xie's factory "refused to let him go, saying he played a key role in production and could not be replaced for the time being." *State-Hired Employee Allowed to Change Jobs*, China Daily, Jan. 25, 1989, at 3. As part of a policy of favoring foreign-funded enterprises, the Beijing Talent Service Exchange Center, a branch of the Beijing Personnel Administration Bureau, ordered the factory to let Xie go. An official of the Center commented: "Many officials still believe the employees are their own property, and refuse to let them go regardless of their own wishes." *Id.* Yet the power to refuse is precisely what the 1986 Director Regulations purport to give them.

A. The Right to Resist Exactions (tanpai)

Article 33 of the 1988 Law on Industrial Enterprises Owned by the Whole People[139] contains the following rule: "The enterprise has the right to refuse exactions of manpower, material, or money by any organ or unit. Except as provided by statute or regulation, any form of demand by any organ or unit upon an enterprise to supply manpower, material, or money is an exaction."

The history of this rule is long and depressing. Local authorities tend to view successful enterprises as milch cows. From local government down to the street committee, from the DIC to the television station, all come seeking money, in one hand a begging bowl, in the other an implicit or explicit threat to withhold vital goods or services such as housing, education for employees' children, or police protection.[140] A recent survey reported by the China News Agency found a total of 241 different fees that could be imposed on construction projects, of which 199 were termed "miscellaneous and excessive."[141]

Uncontrolled exactions play havoc with enterprise business planning because their incidence is so unpredictable. Whoever stands to benefit from a surplus loses any incentive to create that surplus if it is all liable to be taxed away. Furthermore, the central government loses as well, whether as tax collector or as recipient of profits, because enterprises often illegally list amounts paid for exactions as a cost of production, thereby reducing profits.[142]

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139. *Zhonghua renmin gongheguo quanmin suoyouzhi gongye qiye fa* [Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People], 1988 SC BULLETIN 363 [hereinafter State-Owned Enterprise Law or SOE Law].

140. *See generally Guowuyuan pizhuan guojia jingji weiyuanhui, shenji shu, caizheng bu guanyu zhizhi xiang qiye tanpai de qingkuang he yijian de tongzhi* [Notice of the State Council Approving and Transmitting the Report of the State Economic Commission, the Auditing Office, and the Finance Ministry on the Situation and Suggestions Related to the Prohibition of Exactions Upon Enterprises], 1987 FGHB 657 [hereinafter 1987 Suggestions]. Sometimes the threat is more than merely to withhold services. Police in the Zhejiang town of Yongkang allegedly beat a worker from a local tractor factory who had come to the station to get a bicycle licence because the factory had failed to pay a "security fee." *See* Agence France-Presse, *Zhejiang Workers Protest Police Beating*, Nov. 6, 1989, *reprinted in* FBIS, Nov. 11, 1989, at 56.

141. *See Unfair Fees Stalls [sic] Progress*, China Daily, May 28, 1990, Business Weekly 2. Local governments do not confine their attention to enterprises. An investigation by the Ministry of Agriculture found that in some areas, marriage fees reached a total of 700 or 800 *yuan*, including "the cost of the wedding certificate, a physical examination fee . . ., an insurance fee on the couple's love, and a tax on the killing of pigs to be used to entertain guests at wedding ceremonies." Wang Dongtai, *Officials Urged to Ease Burden on Farmers*, China Daily, May 26, 1990, at 1.

142. If the locality has contracted to turn over a fixed amount of taxes each year to the central government (and no more), then the central government need not concern itself with an enterprise's level of profitability, provided it shows a profit. When the enterprise shows a loss, however, it may be up to the central government to provide the subsidies needed to bail it out. Here the inclusion of exactions as a cost of production is crucial for the local government. It can recapture funds from the central treasury by in

Since the early 1980s, the central government has issued regulations forbidding local authorities from exacting (*tanpai*) from enterprises fees and charges not specifically provided for in law. In 1982, the State Council issued *Several Rules on Resolving the Problem of the Excessive Social Burden on Enterprises*[143] which stated that "unreasonable exactions should be abolished."[144] Enterprises which are made to suffer because they refuse to pay such exactions "have the right to make an accusation."[145] In July of 1983, the State Council and the Central Discipline Inspection Commission of the CCP jointly promulgated an *Urgent Notice on Resolutely Curbing the Indiscriminate Raising of Prices of Production Goods and the Indiscriminate Exaction of Fees from Construction Units.*[146] This compared "indiscriminate exactions" to extortion[147] and said they had reached an intolerable level and "must be prohibited."[148] It gave culprits until the middle of the month to change their ways or face severe punishment.[149]

One month later, the Office of the Central Committee of the CCP and the Office of the State Council jointly promulgated a *Notice on Resolutely Curbing Indiscriminate Exactions from Enterprises, Institutions, and Individuals Under the Pretext of "Raising Capital".*[150] This Notice once again called upon all regions, departments, and units to obey the 1982 Several Rules and the 1983 Urgent Notice. It specified that except where tax was collectible pursuant to State Council regulations, all government departments and units were uniformly prohibited from imposing exactions of money or materials upon any unit or individual under any pre-

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effect claiming them in the form of exactions from a loss-making enterprise. This is one reason why the central government is so concerned about exactions, even when they are quasi-regular and do not significantly upset business planning any more than any other kind of legitimate tax. I am grateful to Nicholas Lardy for suggesting this point.

143. *Guowuyuan guanyu jiejue qiye shehui fudan guozhong wenti de ruogan guiding* [Several Rules of the State Council on Resolving the Problem of the Excessive Social Burden on Enterprises], 1982 FGHB 415 [hereinafter 1982 Several Rules].

144. *Id.* at 417.

145. *Id.* at 418.

146. *Guowuyuan zhong-gong zhongyang jilü jiancha weiyuanhui guanyu jianjue zhizhi luan zhang shengchan ziliao jiage he xiang jianshe danwei luan tanpai feiyong de jinji tongzhi* (Urgent Notice of the State Council and the Chinese Communist Party Central Discipline Inspection Commission on Resolutely Curbing the Indiscriminate Raising of Prices of Production Goods and the Indiscriminate Exaction of Fees from Construction Units), 1983 FGHB 464 [hereinafter 1983 Urgent Notice].

147. *Id.* at 464.

148. *Id.* at 465.

149. *See id.* at 466.

150. *Zhonggong zhongyang bangongting guowuyuan bangongting guanyu jianjue zhizhi yi "jizi" wei ming xiang qiye shiye danwei he geren luan tanpai de tongzhi* [Notice of the Office of the Central Committee of the Chinese Communist Party and Office of the State Council on Resolutely Curbing Indiscriminate Exactions from Enterprises, Institutions, and Individuals Under the Pretext of "Raising Capital"], 1983 FGHB 97.

text.[151] Units or individuals which were threatened for refusing to pay illegitimate exactions were given the right to "appeal," and the "relevant departments" were to investigate legal responsibility.[152]

In 1985, the *Temporary Regulations on Several Problems in Enlivening Large and Medium-Sized State-Run Industrial Enterprises*[153] mentioned the problem in passing, but in milder tones than before: "It is necessary to investigate and correct the unreasonable exactions going under all kinds of names that are put on enterprises by society."[154]

In 1986, the State Council promulgated a *Notice on Resolutely Curbing Indiscriminate Exactions From Enterprises.*[155] The 1986 Notice reviewed the repeated admonitions of the State Council against the practice of unjustified exactions and noted with frustration that they were often simply ignored.[156] It repeated earlier prohibitions, but offered nothing new besides, perhaps, a longer list of the various pretexts under which fees could not be levied. In the same year, the State Council and the CCP Central Committee jointly issued the *Regulations on the Work of Directors of Industrial Enterprises Owned by the Whole People.*[157] These regulations also specified that the director had the right to refuse, among other things, exactions of labor or fees from the enterprise.[158]

In 1987, the State Council transmitted a notice instructing recipients to follow the suggestions of a report issued by the State Council Joint Office for the Prohibition of Exactions From Enterprises.[159] The 1987 Suggestions said that the problem of exactions remained quite serious, and in some places had even increased. Like the 1986 Notice, it contained no new solutions, but called for the earnest and firm implementation of the 1986 Notice. Selected typical cases were to be sternly handled and, if especially egregious,

151. *See id.* at 98. The next paragraph provided that local governments could in fact levy other charges provided that they were properly legislated and promulgated publicly.

152. *See id.*

153. *Guojia jingji weiyuanhui, guojia tizhi gaige weiyuanhui guanyu zengqiang dazhongxing guoying gongye qiye huoli ruogan wenti de zanxing guiding* [State Economic Commission and State System Reform Commission Temporary Regulations on Several Problems in Enlivening Large and Medium-Sized State-Run Industrial Enterprises], 1985 FGHB 395.

154. *Id.* at 400.

155. *Guowuyuan guanyu jianjue zhizhi xiang qiye luan tanpai de tongzhi* [State Council Notice on Resolutely Curbing Indiscriminate Exactions From Enterprises], 1986 FGHB 633 [hereinafter 1986 Notice].

156. *See id.* at 633.

157. 1986 Director Regulations, *supra* note 128.

158. *Id.*, art. 29.

159. 1987 Suggestions, *supra* note 140.

publicized nationwide.[160] Finally, the 1987 Suggestions called for the formulation of an "Enterprise Protection Law."[161]

In 1988, the State Council promulgated the *Temporary Regulations on the Prohibition of Exactions From Enterprises*.[162] These provided a non-exhaustive list of items considered to be unlawful exactions, and gave enterprises the "right" to refuse to pay them.[163] Enforcement generally was put in the hands of auditing organs.[164] In November 1989, the CCP Central Committee issued its *Decision on Further Improving the Economic Environment, Straightening Out the Economic Order, and Deepening the Reforms*.[165] This document repeated that "[n]o department, office, institution, or enterprise is allowed to resort to such extortion on any excuse." Violators were threatened with punishment, and enterprises, institutions, and individuals were given "the right to refuse to pay the fees and fines or share in the financial burdens imposed in violation of state regulations."[166]

Merely reviewing the legislative history is enough to suggest that all these regulations have been essentially useless, and empirical investigation confirms it. Exactions are often made under the guise of inspections. The more successful an enterprise is, the more it will be subject to various inspections and arbitrarily fined or required to pay a fee in order to pass.[167] One enterprise reported that inspection teams, no doubt intending to save time all around, openly demanded payment of a certain sum the moment they arrived at the factory.[168]

Although schools and police are forbidden in the most explicit possible terms from exacting fees from enterprises,[169] such demands appear to be common.[170] Nor are enterprises frequently able to re-

160. *See id.* at 660. The media were cautioned *not* to publicize the methods by which offenders had extracted money from enterprises.

161. *See id.* at 661.

162. *Jinzhi xiang qiye tanpai zanxing tiaoli* [Temporary Regulations on the Prohibition of Exactions From Enterprises], 1988 SC BULLETIN 387 [hereinafter Temporary Regulations].

163. *See id.*, art. 13.

164. *See id.*, arts. 16-18.

165. Chinese Communist Party Central Committee, Decision on Further Improving the Economic Environment, Straightening Out the Economic Order, and Deepening the Reforms, *excerpted and translated in* BEIJING REV., Feb. 12, 1990, at I.

166. *Id.* at X-XI.

167. *See Zhongguo shehui kexue yuan jingji yanjiu suo guoyouzhi keti zu* [State Ownership Project Group, Institute of Economics, Chinese Academy of Social Sciences], *Sanshi'er-jia guoyouzhi qiye fangtan lu* [Record of Visits and Discussions at Thirty-Two State-Owned Enterprises] 111, 129 (Oct. 1988) [hereinafter SOPG] (on file with author). This source is a report of the results of an investigation of state-owned enterprises, in which the author participated, conducted in China in the summer of 1988.

168. *See id.* at 111.

169. *See* 1988 Temporary Regulations, *supra* note 162, art. 4.

170. *See, e.g.*, SOPG, *supra* note 167, at 77, 105, 135.

fuse payment, despite the "right" to do so supposedly given them by the State-Owned Enterprise Law.[171] The reason for this is simple: those who demand fees can withhold something the enterprise needs or impose a burden, such as a fine, that the enterprise does not want. The threat of withholding goods and services can be credibly wielded by schools, because they can refuse to admit the children of employees from an uncooperative enterprise.[172] The police can, and in one reported case did, refuse to register enterprise employees for domicile and unemployment matters. Moreover, they refused to act on crimes involving the enterprise. When the enterprise complained to the local government, it was told to pay up for the sake of good relations.[173] Other government departments exercise similar kinds of leverage over the enterprise because of the enterprise's needs for finance, manpower, and material supplies.[174]

The root of the enterprise's inability to refuse exactions, therefore, lies not in the insufficiency of statutory law or in the problems of the court system, but in the fact that enterprises are required to have continuing relationships with various organizations and do not have the option of exit.[175] In addition, enterprise managers may well have a career track in the very bureaucracy that is demanding the payment, and so will be extremely hesitant to offend their superiors.[176]

There are a number of ways to reduce the incidence of illegitimate exactions, some of which are more effective than others. First, superior government organs can order inferior organs to stop making such demands. This method, as the history of the rule against exactions shows, is utterly ineffective. No effective mechanism exists that could make such orders meaningful. In addition, superior governmental organs are often forced to turn a blind eye even to those exactions they know about because exactions may be the only source of funds for needed local infrastructure.[177]

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171. *See generally* Gong Jinhang, *Qiyejia de kunhuo: changzhang fuzezhi shixing hou de xin wenti* [Perplexity for Enterprise Managers: New Problems Following the Trial Implementation of the Factory Director Responsibility System], FAXUE [Jurisprudence] (Shanghai), No. 6 (1987), at 35, 36. Only one enterprise reported that the State-Owned Enterprise Law had been effective in helping it resist an exaction from the Neighborhood Committee. It did not specify how. *See* SOPG, *supra* note 167, at 21.

172. *See* SOPG, *supra* note 167, at 77, 135.

173. *See id.* at 82.

174. *See Survey Spotlights Apportionments*, BEIJING REV., Jan. 16, 1989, at 30, 40.

175. On the notion of exit, *see* A. HIRSCHMAN, EXIT, VOICE, AND LOYALTY (1970).

176. The Legal System Daily recently reported a suit for breach of contract brought by the manager of a purchase and supply station against its superior department, the local commercial bureau. The manager won his lawsuit but lost his job. *See Yiwei jingli yingle guansi* [A Manager Won His Lawsuit], Fazhi ribao [Legal System Daily], Nov. 23, 1990, at 3.

177. This is implied by *Survey Spotlights Apportionments*, *supra* note 174, at 30. This system of local government finance is similar in many ways to that of Qing dynasty

Second, enterprises can be given the legal right to take those who demand illegitimate fees to court. This right is useless. Enterprises that submit do so because they dare not offend superior governmental organs by not paying. If they dare not refuse to pay, they will certainly dare not challenge the exaction in court.[178]

Third, enterprise managers suffer personally if exactions are paid. A rule attempts to do this by forbidding the inclusion of such payments as a cost item. Instead, they must be paid from after-tax profits. How much of a disincentive this is to decision makers depends on who actually suffers from a reduction in after-tax profits. The rule also requires detailed auditing to be effective.

Fourth, enterprises could be made less dependent upon the organizations now in a position to exact payments from them. This could be done in a number of ways, such as breaking up monopolies and reducing the number of permits and licenses needed for various activities. However, implementing such a large structural change and "breaking up monopolies" is easier said than done. Additionally, as government departments lose their ability to enforce illegal policies, they also lose their ability to enforce legal and legitimate ones.

For example, local environmental protection offices are notoriously weak in enforcing the Environmental Protection Law.[179] In one case, the Environmental Protection Office of Baiyun District in Guangzhou fined a local restaurant for excessively dirty water. Not only did the restaurant refuse to pay, but it appealed the fine to the local court and won.[180] The winning itself may not be remarkable — we do not know the facts of the case. What is interesting is that the restaurant dared to appeal. How was this possible when at the same time the restaurant was likely required to make payoffs to numerous other local agencies?

The answer is that the restaurant was not locked into a continuing relationship with the local environmental protection office.

China. Magistrates, the key officials responsible for local administration, had enormous expenses and limited incomes. They were therefore allowed to collect "customary fees" on every imaginable occasion. Although this practice was tolerated, there was often no sharp dividing line between the collection of "customary fees" and outright corruption. *See* CH'Ü T'UNG-TSU, LOCAL GOVERNMENT IN CHINA UNDER THE CH'ING 22-32 (1982). I am grateful to William Alford for suggesting this point.

178. See SOPG, *supra* note 167, at 33, where it is pointed out that the enterprise would probably lose the lawsuit in any case.

179. China has a number of central and local regulations dealing with environmental protection. The first national Environmental Protection Law was passed "for trial implementation" in 1979. *See Zhonghua renmin gongheguo huanjing baohu fa (shixing)* [Environmental Protection Law of the People's Republic of China (for Trial Implementation)], 1979 FGHB 239. The final version was not promulgated for another decade. *See Zhonghua renmin gongheguo huanjing baohu fa* (Environmental Protection Law of the People's Republic of China), 1989 SC BULLETIN 942.

180. *See* Jin Ping, *supra* note 122, at 9.

The office had nothing it could threaten to withhold. The 1988 Temporary Regulations list (and forbid) no less than fourteen imaginative pretexts for the exaction of fees, but none has anything to do with environmental protection. Respondents in a survey of thirty-two industrial enterprises mentioned all kinds of organizations that attempted to exact fees from them — schools, police, utilities, superior departments, banks, taxation, and even television and radio[181] — but none ever accused the environmental protection authorities of wrongdoing. This cannot be explained solely by the superior moral character of environmental protection officials.

A final, if perhaps unacceptable, way of eliminating exactions is to make enterprises entirely the creature of local authorities. In this way, exactions will lose their character as forced payments from one entity to another and will become merely an accounting notation as money is taken from one municipal pocket and put into another. In effect, local government will internalize the cost of exactions paid to local government. This reflects to some extent the situation before enterprises were given more independence. All the enterprise's dealings were with its superior department, which handled its relations with other units such as banks and police and could in effect rationalize exactions.[182] Cash and materials went to the city government, and then were redistributed as needed. Now subordinate units have more independence, but this means they have more independence to exact illegal fees, because the process was one of administrative decentralization, not market decentralization. While fewer administrative controls exist over institutions like schools and the police, no legal control has replaced the lost administrative control.

B. The Right to Hire and Fire Employees

The State-Owned Enterprise Law gives enterprises the right to employ and dismiss low-level staff and workers in accordance with statute and the rules of the State Council.[183] Furthermore, the director has the general right to hire and discharge middle-level administrative cadres of the enterprise.[184] However, the right to hire and fire appears to exist for the most part in name only.[185] Enterprises almost uniformly report that these provisions of the State-Owned Enterprise Law cannot be realized in practice.[186]

181. *See* SOPG, *supra* note 167, at 77.

182. *See id.* at 14, 33.

183. State-Owned Enterprise Law, *supra* note 139, art. 31.

184. *Id.*, art. 45.

185. One manager specifically described it as a "formality" (*xingshi*). *See* SOPG, *supra* note 167, at 77.

186. *See id.* at 17-18, 33, 40, 47, 50, 62, 71, 77, 92, 97, 100, 105, 129; Li Zhuoyan, *Why Enterprise Directors Quit*, China Daily, Feb. 11, 1989, at 3, col. 3; Gong Jinhang,

The State-Owned Enterprise Law and associated regulations operate as instructions to the bureaucracy in charge of an enterprise. They do nothing to alter the actual power of the bureaucracy, but merely tell it to exercise its power in a different way. Thus, the legal rule that "the director has a right to do X" means that the department in charge should allow the director to do X and support the decision. The director has no recourse if the DIC does not allow him to do X. The rule that he has a "right" is intended to be *followed* by the DIC, not *applied* by some adjudicating body in the course of resolving a dispute between the director and the DIC. Because no mechanism has been created for enforcing the duty of the DIC to follow the law, there is little reason to expect it to do so.[187]

We still need to understand, however, why the enterprise's administrative superiors balk at giving the director so much control over manpower. With respect to ordinary staff and workers, the explanation lies in the crucial social welfare function served by enterprises. The state distributes to urban workers benefits such as housing subsidies, medical care, and child care through enterprises. One director reported that his factory had "everything but a crematorium."[188] The consequences of separation from the enterprise thus are extremely severe for the workers, and they will go to great lengths to prevent it.[189] Fearing social disruption and unwilling to adopt coercive measures in response, authorities pressure enterprises to keep the workers in the factory.[190]

Another reason frequently given for the reluctance of the au-

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supra note 171, at 36. A particularly egregious example of the difficulty in firing workers is reported in Liu Aiming, *Falü de tianping shi fou qingxie?* [Are the Scales of the Law Atilt?], FALÜ YU SHENGHUO [Law and Life], No. 72 (1989), at 16, where the intermediate-level court of Yancheng City overturned an enterprise's decision to fire a worker who had been absent 18 days without excuse, even though the firing had been approved by the enterprise's labor union.

187. "Little reason" does not mean "no reason." The real world is not populated by perfectly rational wealth maximizers armed with perfect information and unhampered by transaction costs. Real officials may have a propensity to follow a rule simply because it is a duly promulgated rule. The argument here is that we will observe a *greater* degree of rule following in a system with a mechanism for enforcing the duty to follow rules than in a system without one. A number of Chinese analysts take the view that in the Chinese system, there is insufficient rule following by DICs. *See, e.g.*, Wang Shirong, *Jinyibu jiaqiang fazhi jianshe; wei shenhua qiye gaige baojia huhang* [Further Strengthen the Establishment of the Legal System; Protect the Deepening of Enterprise Reform], Fazhi ribao [Legal System Daily], Jan. 21, 1988, at 1.

188. SOPG, *supra* note 167, at 106.

189. *See infra* note 246 and accompanying text.

190. If enterprises are to be given real power to hire and fire workers, then the state will have to assume the burden of welfare and other services by creating a national social security and pension system; significant changes will also be required to provide the housing, health, and educational services hitherto provided mainly by state enterprises.
Lin, *Open-Ended Economic Reform in China*, in REMAKING THE ECONOMIC INSTITU-

thorities to allow enterprises to discharge workers is that "society" (local government) could not bear the load of supporting so many unemployed.[191] Keeping the unemployed within enterprises can be a rational strategy for local governments. Because China does not have a centrally-funded welfare system, any social assistance to the unemployed must be borne entirely by local government. If the same people can be supported by an enterprise, then the local government bears the cost only to the extent that it has a claim on the profits of the enterprise. While this claim may be large, it can never be complete as long as the central government taxes profits. Moreover, to the extent that the center subsidizes enterprise losses, it will bear the cost of the excessive wage bill that might have caused them.

With respect to middle and higher level managerial personnel, the ability of the director to hire and fire according to his or her own preferences is compromised by a pervasive ambivalence in relevant law and policy. The ambivalence is over the degree to which political qualifications should be required of managerial personnel. The perceived need to ensure that only right-thinking managers are in positions of power stems from the inability of the state to establish structures to curb the activities of wrong-thinking managers.[192] Nevertheless, the government recognizes that the politically qualified are not always the most talented managers. Therefore, it has tried to establish a system of mutual checks and balances that avoids as far as possible the question of who has the last word when agreement cannot be reached.

TIONS OF SOCIALISM: CHINA AND EASTERN EUROPE 95, 108 (V. Nee & D. Stark eds. 1989).

191. *See, e.g.*, SOPG, *supra* note 167, at 47.

192. The desire to put right-thinking people at the helm bears resemblances to, but should not be confused with, a system of political patronage. Patronage is essentially a system of rewards for services rendered. The main concern is to provide the beneficiary with a sinecure. The nature of the post is of secondary importance. It is perfectly consistent with a system of political patronage to create a position of absolutely no importance or useful function solely to provide the beneficiary with a government job. In the Chinese system, however, the government is vitally concerned with the nature of the job and how the holder carries out her tasks. The post of enterprise manager is not simply a sinecure; it carries with it real powers and important functions. In short, the Chinese system carries to a much lower echelon the limited system of "patronage" (if we wish to call it that) that was permitted to remain by the Supreme Court in Rutan v. Republican Party of Illinois, 110 S.Ct. 2729 (1990) (recognizing a government interest in securing employees who will loyally implement its policies but limiting hiring and firing based on political views to "certain high-level employees"). In both cases, political loyalty can be seen as a *bona fide* occupational qualification, whereas in a system of patronage grounded in the reward principle, occupational qualifications are simply irrelevant. Those who support the patronage system do so on the grounds that it is a necessary component of party politics, not on the grounds that Republicans make better garbagemen than Democrats. *See, e.g.*, Editorial, *A Judgment on Politics*, Chicago Tribune, June 29, 1990, at 18, col. 1; Will, *The Benefits of Patronage*, Washington Post, June 28, 1990, at A25, col. 2.

Regulations regarding the role of the Party committee in enterprise governance manifest this ambivalence fully. On the one hand, director incentive schemes operate on the assumption that motivating the director a certain way will make the enterprise behave a certain way. This will not occur if the director does not have full power over enterprise behavior. Yet the government remains reluctant to yield full decision making power to technocratic managers. The dilemma is resolved with a technique not uncommon in Chinese legislation: the insertion of a vague formula at just the place where precision is most needed. This resolution comes with a cost, however: it reproduces the very uncertainty which the law was meant to eliminate.[193]

In common law jurisdictions with powerful courts, judges show little hesitation in stepping into the breach when no clear rule exists. To say that the court cannot act because there is no law is, in a system where courts have the last word on the law, to rule in favor of the defendant. Because China does not have such a system, a lack of clear law may well mean that legal institutions simply have no role to play. The ambiguity must be resolved by some other institution or institutions: in this case, the CCP and the press.

In 1986, the CCP Central Committee and the State Council issued three sets of regulations together intended to govern decision making within the enterprise. These were *Regulations on the Work of Directors of Industrial Enterprises Owned by the Whole People*,[194] *Regulations on the Work of Basic-Level Organizations of the Chinese Communist Party in Industrial Enterprises Owned by the Whole People*,[195] and *Regulations on the Congress of Staff and Workers in Industrial Enterprises Owned by the Whole People*.[196] These regulations called for the implementation of the director responsibility system and purported to give the director several important powers, among them the power to hire and fire middle-level cadres without obtaining the approval of the enterprise's administrative superior.[197]

In cases of disagreement with the management committee, the

193. This vagueness is criticized in Xu Kaishu, *Qianghua qiye jingying quan de ruogan falü wenti* [Several Legal Issues in Strengthening the Management Rights of Enterprises], WEIDING GAO [Unfinished Drafts], No. 7 (1989), at 27, 31.

194. 1986 Director Regulations, *supra* note 128.

195. *Zhongguo gongchan dang quanmin suoyouzhi gongye qiye jiceng zuzhi gongzuo tiaoli* [Regulations on the Work of Basic-Level Organizations of the Chinese Communist Party in Industrial Enterprises Owned by the Whole People], 1986 FGHB 593 [hereinafter 1986 Party Organization Regulations].

196. *Quanmin souyouzhi gongye qiye zhigong daibiao dahui tiaoli* [Regulations on the Congress of Staff and Workers in Industrial Enterprises Owned by the Whole People], 1986 FGHB 601 [hereinafter 1986 Enterprise Congress Regulations].

197. *See* 1986 Director Regulations, *supra* note 128, art. 27.

director was given the right of final decision.[198] On the other hand, in cases of disagreement with decisions of the congress of staff and workers, the director was obliged to carry out the decision while reporting the matter to the superior department.[199]

Left vague was the allocation of power between the director and the Party committee. According to the 1986 Party Organization Regulations, the latter was supposed to "guarantee and supervise" (*baozheng jiandu*)[200] the achievement of a number of vaguely-worded aims: maintaining a "socialist orientation;" ensuring that the staff and workers enjoyed democratic rights; correctly handling the interests of the state, enterprise, and work force; obeying discipline and law; and implementing Party policy.[201] These goals would be met by conducting work among Party members within the enterprise and by offering suggestions and proposals to the director.[202] The enterprise director, although required to exercise "unified leadership" and to be "completely responsible" for the enterprise,[203] was also required to report periodically to the Party organization and to "accept supervision."[204]

The key question is whether a relationship of supervision implies a relationship of command and subordination. The initial answer of the regulations and subsequent commentary appeared to be no.[205] The 1986 Party Organization Regulations implied that in cases of unresolvable differences with the director, the final remedy of the Party committee was to report the matter to the superior administrative department or the superior Party organization.[206] This interpretation of "supervision" had already been explicitly stated in a 1985 article in *Economic Management*.[207] Another writer implied that to "supervise" was something less than to "lead" (*lingdao*).[208] A 1987 book on enterprise law simply repeats the formula of the 1986 Party Organization Regulations.[209]

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198. *See id.*, art. 26.

199. *Id.*, art. 30.

200. 1986 Party Organization Regulations, *supra* note 195, art. 1.

201. *See id.*, art. 16.

202. *See id.*, art. 17.

203. *See* 1986 Director Regulations, *supra* note 128, art. 2.

204. *See id.*, art. 5.

205. Heath B. Chamberlain reaches the opposite conclusion with respect to an earlier period. *See* Chamberlain, *Party-Management Relations in Chinese Industries: Some Political Dimensions of Economic Reform*, 1987 CHINA Q. 631, 651-652.

206. *See* 1986 Party Organization Regulations, *supra* note 195, art. 15.

207. *See* Sun Fakui & Zhao Yuhui, *Guanyu qiye dangwei shixing baozheng jiandu ruogan wenti de tantao* [An Investigation into Several Problems Relating to the Carrying Out by the Enterprise Party Committee of Guarantee and Supervision], JINGJI GUANLI [Economic Management], No. 12 (1985), at 23, 25.

208. *See* XIONG XIANJUE, ZHONGGUO SIFA ZHIDU [The Judicial System of China] 221 (1986).

209. *See* QIYE FALÜ ZHISHI 400 WEN [400 Questions on Enterprise Law] 13 Shang-

Apart from specialized discussions of the meaning of "guarantee and supervise", documents and articles stressed the powers of the director and the notion that this power was intended to be a change from the previous system. The key verbal formula was that of the "central" (*zhongxin*) position and role of the director. Although the term did not appear in any of the three regulations issued in September 1986, it showed up two months later in a supplementary notice on implementation issued by the Central Committee and the State Council.[210] The purport of this notice is unmistakable:

> The change from the system of director responsibility under the Party committee to the director responsibility system is a major reform in the enterprise leadership system. The director . . . is the head of the factory; he is the legal representative of the enterprise; he is completely responsible for the enterprise; he occupies the central position and plays the central role. . . . The Party organization must . . . actively support the director (manager) in the exercise of his functions and powers.[211]

The "central" position of the director and his powers were subsequently codified in Article 45 of the State-Owned Enterprise Law.[212] A Party circular issued two weeks after the promulgation of the State-Owned Enterprise Law emphasized that the intent of the law was to downplay the role of the party organization: "It is a new issue that the director [and not the Party] is in charge of an enterprise's material and spiritual construction."[213]

> We must clearly realize that enterprises are not political organisations and that the functions of Party organisations within enterprises are different from those of central and local Party committees which undertake political leadership. According to the decision of the 13th Party Congress, Party organisations in enterprises will exercise supervisory functions instead of exercising "centralized" leadership over enterprises as before. Party organisations within enterprises should direct their main attention

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hai cai-jing daxue jingji xi jingji fa jiaoyan shi [Economic Law Teaching and Research Office, Department of Economics, Shanghai University of Finance and Economics] (1987).

210. *Zhonggong zhongyang, guowuyuan guanyu renzhen guanche zhixing quanmin suoyouzhi gongye qiye sange tiaoli de buchong tongzhi* [Supplemental Notice of the CCP Central Committee and the State Council on Conscientiously Implementing the Three Regulations on Industrial Enterprises Owned by the Whole People], 1987 SC BULLETIN 21.

211. *Id.* at 21. The formula was repeated in a 1987 article in the People's Daily: "The factory director is the head of the whole factory. He is at the center of the enterprise and gives full play to his central role. The Party committee mainly grasps the work of the Party's own organizational construction and enterprise ideological and political work." Dai Yuqing, *Qiye dangwei shuji de zhize* [The Responsibility of the Enterprise Party Committee Secretary], Renmin ribao [People's Daily], Nov. 9, 1987, at 2, col. 2.

212. *See* State-Owned Enterprise Law, *supra* note 139, art. 45.

213. *Party Circular on Enterprise Law*, in SWB/FE, May 13, 1988, at B2/1, 2.

> to building stronger Party organs. They should . . . support the directors in fully exercising their powers in the light of the "enterprise law" . . . . The director will take over the responsibility of doing ideological and political work among the workers.[214]

In its single mention of the role of the Party organization, the State-Owned Enterprise Law repeats the formula that calls for the Party committee to "guarantee and supervise" the implementation of the orientations and policies of the Party and the state.[215]

Post-SOE Law commentary on the meaning of "guarantee and supervise" was not markedly different from that which preceded it. One writer makes clear that "supervision" means something less than what the Party was doing before:

> [Article 8 of the State-Owned Enterprise Law] makes clear that the director is the head of the factory. He occupies the central position in the factory and plays the central role. Consequently, there is a change in the duties and functions of the Party organization within the enterprise. The Party organization no longer directly directs production and operations and administrative management work and no longer discusses and decides major issues in production and operations. The Party organization *only* guarantees and supervises the implementation within the enterprise of Party and state orientations and policies.[216]

The State-Owned Enterprise Law and associated policy documents bespoke a clear intention to decrease substantially the role of the Party committee in the enterprise.[217] This policy appears now to have been reversed. A clear sign of this is the resurrection of references, since Zhao Ziyang's fall, to the "core" (*hexin*) position of the Party committee, a term that had fallen by the wayside since at least 1985. An article published in that year explicitly repudiated the "old concept" (*jiu de guannian*) of the Party as the leadership core of the enterprise, along with the notion that "the Party committee exercises unified leadership and the Party secretary has the final say."[218] A 1987 article in the *People's Daily* also rejected the notion of the "core" position of the Party secretary and stressed the "central position" and "central role" of the director.[219] In an authoritative recent article in the *People's Daily*, however, Gao Shangquan, the Vice Minister of the Commission for Restructuring the Economy, stressed the position of the Party committee as "the core

214. *Id.* at B2/3.

215. *See* State-Owned Enterprise Law, *supra* note 139, art. 8.

216. ZHONGHUA RENMIN GONGHEGUO QUANMIN SUOYOUZHI GONGYE QIYE FA SHIYI [Commentary on the People's Republic of China Law on Industrial Enterprises Owned by the Whole People] 22 (Zhu Xisen ed. 1988) (emphasis added).

217. For an excellent study of Party-management relations in the 1980s prior to the promulgation of the State-Owned Enterprise Law, *see* Chamberlain, *supra* note 205, at 24.

218. Sun Fakui & Zhao Yuhui, *supra* note 207, at 24.

219. *See* Dai Yuqing, *supra* note 211, at 2.

in every enterprise."[220] He did not mention the "central" position of the director at all.

Of course, the notion that some innate and obvious distinction can be made between a "core" and a "center" is somewhat forced.[221] It serves the purpose, however, of reversing policy while being able to maintain that nothing has changed.[222] The comeback of the Party committee is evident particularly clearly in the director's power over personnel. Article 45 of the State-Owned Enterprise Law gives the factory director the right to hire and fire middle-level administrative cadres in the enterprise.[223] The 1988 Party circular mentioned above[224] makes the same point: "Enterprise deputy directors and other mid-level administrators should be nominated, appointed and recruited by the director according to regulations."[225] As early as 1985, an article in *Economic Management* had specifically put this matter among those regarding which the Party committee's "discussion" could lead only to suggestions and proposals, with the final decision resting with the director.[226]

Compare these interpretations with the measures adopted by the Lanzhou Municipal Party Committee in October, 1989:

> [All] middle-level administrative cadres should be investigated by organisation departments of their Party committees, discussed collectively by Party committees to present its [sic] opinions and suggestions and then discussed collectively by administrative leaders before they are appointed or dismissed by their directors or managers. Meanwhile, directors and managers of industrial enterprises must submit all major problems to Party committees for discussions and make major decisions after listening to opinions and suggestions put forth by Party committees. Factory directors and managers must regularly report back on their

220. Gao Shangquan, *supra* note 34, at 1.

221. When I visited a number of enterprises in a large Chinese city in the fall of 1990, most of the managers in fact ridiculed the distinction.

222. In September, 1989, Mr. Yuan Baohua, the president of the China Enterprise Management Association, said that contrary to alarmist rumors, the attention being given to the "core position" of the Party organization did not mean that Party secretaries were going to infringe on the "central position" of managers. *See* CHINA NEWS ANALYSIS, Nov. 1, 1989, at 9 (citing People's Daily, Sept. 17, 1989).

223. That this right was intended to be relatively unqualified is shown by the previous paragraph in the same Article, which provides that the hiring and firing of cadres at the vice director level must be approved by the government department in charge of the enterprise. Middle-level cadres are the following: deputy chief engineer, deputy chief accountant, deputy chief economist, heads and vice heads of workshops, heads and vice heads of functional sections (*zhineng ke*), and other administrative leading cadres. *See* FANG WEILIAN & WANG ZIMU, "QUANMIN SUOYOUZHI GONGYE QIYE FA" JIANGHUA [Lectures on the "Law on Industrial Enterprises Owned by the Whole People"] 215 (1988).

224. *See Party Circular on Enterprise Law, supra* note 213 and accompanying text.

225. *Id.* at B2/2.

226. *See* Sun Fakui & Zhao Yuhui, *supra* note 207, at 25.

work to Party committees and solicit their opinions and suggestions."[227]

The tone is unmistakable and the reverse in policy clear. What is more, the new policy can be carried out within the confines of existing legislation merely by redefining key terms such as "supervision." The redefinition, however, takes place *outside* of the statute. The statute is simply not viewed as a satisfactory means for effectuating a particular policy when it counts. The real policy change, quite evident from Party pronouncements and press articles, never showed up on the statute books.

C. Bankruptcy Legislation

A great deal of the perceived unsatisfactory behavior of enterprises stems from their soft budget constraint.[228] A keystone of the effort to harden the budget constraint through explicit legal rulemaking is the Bankruptcy Law.[229] The law provides that enterprises that consistently lose money should be closed down[230] and workers and managers made to suffer in some way. Without the threat of bankruptcy, the rule makers fear that economic punishments, whether imposed by law or the market, will not be felt by enterprises and economic regulations will remain weak.

Importantly, the Bankruptcy Law also seeks to harden what might be called the legal constraint: it attempts to make it more difficult for the enterprise to win an exemption from the rule on the basis of special pleading. The law achieves this hardening effect by taking decision making power out of the hands of the government department in charge of the enterprise (which always had the power to close it down under the old system) and putting it in the hands of creditors (who can initiate the process) and courts (who make the final decision).

The Bankruptcy Law was officially passed, after several false starts, in December of 1986, but opponents managed to insert a clause stating that the law would not go into effect until three months after the implementation of a future law on state-owned enterprises (subsequently known as the State-Owned Enterprise Law). Because the State-Owned Enterprise Law did not come into effect until August 1, 1988, the Bankruptcy Law did not go into effect until three months later, on November 1, 1988.

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227. *Lanzhou to Strengthen Party Role in Enterprises*, in SWB/FE, Oct. 21, 1989, at B2/1.

228. *See* Perkins, *Reforming China's Economic System*, 26 J. ECON. LIT. 601, 604 (1988).

229. Bankruptcy Law, *supra* note 118.

230. Article 3 provides: "An enterprise that has suffered serious losses due to poor management and is unable to pay obligations that have become due [*daoqi zhaiwu*] shall be declared bankrupt [*xuangao pochan*] in accordance with this Law."

The Bankruptcy Law was specifically labeled "for trial implementation." Even so, only one instance of a state-owned enterprise being closed down through court action under the Bankruptcy Law had been reported by February 1991.[231] This is not because state-owned enterprises suddenly started performing well. Industrial enterprises under the state budget suffered losses of RMB 6.87 billion in the first half of 1988, more than the amount for all of 1987.[232] Nineteen percent of industrial enterprises under the state budget were in debt in 1989, up thirteen percent from 1988.[233] The austerity policies of late 1988 have led to huge amounts of inter-enterprise debt.[234] In short, candidates for bankruptcy abound. Why has the law been such a dead letter?

The Bankruptcy Law, even in its most general principles, fails to take account of fundamental facts of Chinese social and economic life. First, in a society of controlled prices, profits do not mean efficiency and losses do not mean inefficiency.[235] The coal

231. A state-owned motorcycle factory in Nanchang, Jiangxi Province, was declared bankrupt by the Nanchang Intermediate People's Court on December 6, 1989. A collectively-owned cardboard box factory was declared bankrupt at the same time, although the reports did not specify the governing law. *See State-Owned Factory Declared Bankrupt*, in SWB/FE, Dec. 9, 1989, at B2/1; *Chinese Plant Is Bankrupt*, N.Y. Times, Dec. 8, 1989, at D5, col. 3. The municipal government of Chongqing is reported to have auctioned off an insolvent state-owned enterprise "in line with" the Bankruptcy Law in January, 1991, but no court seems to have been involved. Instead, it appears to have been a case of the owner (the city) unloading a white elephant for what it could get. All the workers were reassigned to other local enterprises. As is the case in many so-called enterprise "mergers" in China, this transaction appears to have been a disguised land sale: the buyer wanted the premises, not the facilities. *See State-Owned Factory Auctioned*, China Daily, Jan. 11, 1991, at 2.

232. *See Financial Subsidies: A Heavy Burden on National Economy*, CHINA ECON. NEWS, Sept. 11, 1989, at 5.

233. *See Chinese Debt Seen Rising*, N.Y. Times, Feb. 7, 1990, at D22, col. 5. A recent source states that 20% of state-owned industrial enterprises are in the red. *See What Next for Enterprise Reform?*, CHINA ECON. NEWS, July 2, 1990, at 1. The significance of these figures is not always obvious. First, the general level of profitability in the industrial sector may be simply a function of state-set transfer prices between it and the commercial sector and of little economic significance. Second, losses in the industrial sector may be heavily concentrated in a few industries, such as coal. Nevertheless, the coal industry would account for only a small proportion of the absolute number of industrial enterprises showing a loss.

234. Inter-enterprise debt is called "triangular debt" in China where it is not between two enterprises that can simply cancel out their mutual obligations. For example, Enterprise A owes money to Enterprise B, which owes money to Enterprise C, which owes money to Enterprise A. None can pay off the debt until the debt owed it is paid. Tight credit control had led to triangular debt of over 100 billion *yuan* by November, 1989. *See* O'Neill, *Peking Bargains with Angry Provinces*, Reuter Library Report, Nov. 1, 1989, BC Cycle (available on NEXIS). For an analysis of the peculiar problems presented by triangular debt within the Chinese economy, see Fan Gang, *Enterprise's Debts and the Issuance of Currency* (in Chinese), JINGJI CANKAO [Economic Reference], Jan. 16, 1990, at 4, *translated in* FBIS, Feb. 23, 1990, at 24.

235. For more on this point, *see, e.g.*, Byrd & Tidrick, *supra* note 37, at 65, 83; Hung & Wiemer, *supra* note 36, at 70, 74; Li & Wu, *Shixing pochan fa suo ying jubei de qianti*

industry is a notorious loss-maker,[236] but this is the result more of artificially depressed prices for coal than of inefficient operations.[237] Closing down enterprises simply because they make losses would be irrational and unfair. The proponents of the Bankruptcy Law were undoubtedly aware of this. At the time the Bankruptcy Law was being drafted, however, price reform was on the agenda and drafting proceeded on the assumption that prices, and hence profits, would soon mean something. When the failure of price reform became clear, the only solution, short of abandoning the whole project, was to put a fault standard into the law.

Article 3[238] implies that enterprises should not be put out of business when their losses are *not* due to poor management, so as to protect those enterprises whose losses are the result of, *inter alia,* fixed prices, production quotas, and rigid labor allocation. The Bankruptcy Law fails, however, to provide a standard for distinguishing good losses ("policy losses") from bad losses ("business losses"). These losses do not come with labels on them.[239] This puts the whole procedure right back in the realm of bargaining and special pleading from which the Bankruptcy Law was supposed to remove it. The system continues to reward good bureaucratic connections more than it rewards cost-cutting.

The fault standard was introduced into Chinese bankruptcy law in order to preserve efficient, useful enterprises that lose money when those losses are the result of deliberate government policy. Its reach, however, is too broad: it also preserves enterprises that lose

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tiaojian [Prererequisite Conditions to the Enforcement of the Bankruptcy Law], JINGJI GUANLI [Economic Management], No. 10, 1986, at 68, *translated in* CHINESE ECON. STUDIES, Winter 1988, at 16, 19-20; Lin, *supra* note 38, at 47; Shirk, *The Politics of Industrial Reform*, in THE POLITICAL ECONOMY OF REFORM IN POST-MAO CHINA 195, 200 (E. Perry & C. Wong eds. 1985). Two prominent Chinese economists provide an example:

> One ton of steel provided at the state price is equivalent to a 1000 yuan subsidy. This shows how easily one can make a large profit. The enterprise need only elicit a high input quota and a reduced output quota, instead of improving managerial skill and reducing production costs.

Wu & Zhao, *The Dual Pricing System in China's Industry*, 11 J. COMP. ECON. 309, 315 (1987).

236. *See* ZHONGGUO TONGJI NIANJIAN 1988 [Statistical Yearbook of China 1988] 378 (1988).

237. *See Wang Bingqian's Budget Report*, in SWB/FE, Apr. 19, 1990, at C2/1, 10 (report on the implementation of the 1989 state budget and the 1990 draft budget delivered to NPC by Wang Bingqian, State Councillor and Minister of Finance) ("[C]oal . . .enterprises have incurred greater losses [than before] because they cannot substantially increase their prices in accordance with rising production costs.").

238. *Quoted in part* in *supra* note 235.

239. As one well-known Chinese economist has noted, "[I]t is sometimes rather difficult to distinguish the deficits of an economic nature [*i.e.*, business losses] from those of a policy nature." Dong, *Tan qiye pochan zhi* [On the Enterprise Bankruptcy System], Renmin ribao [People's Daily], Oct. 10, 1986, at 5, *translated in* FBIS, Oct. 21, 1986, at K10, K10.

money simply because they are unproductive — buggy-whip factories or nearly exhausted mines — provided only that they are well managed. Second, the urban work unit, of which industrial enterprises are an example, plays a key role in the organization of Chinese society. The urban population receives various welfare benefits through the work unit such as cheap housing, special wage subsidies, ration coupons, theater tickets, vacations, health care, child care, and old age pensions. No effective way has been devised to distribute these benefits save through the work unit.[240]

As the Polish Communists repeatedly discovered, the government can only force so much in the way of unpopular policies down the throats of the populace, no matter how objectively necessary they might be. The current Chinese government simply cannot close down large numbers of enterprises and put urban workers out of work. Not only is it manifestly unfair, in the light of pervasive government control of the economy, to put workers out of work simply because their enterprise's books show a loss, but the welfare benefits supplied by these enterprises are simply too important to lose without a fight. The consequences of separation from the enterprise are so severe for the workers that they will adopt extreme strategies such as threats, demonstrations, sit-ins, and even violence against managers to prevent it.[241] Enterprise managers uniformly report that discharging workers is virtually impossible,[242] although it is sometimes possible to stop wage payments completely if the workers do no work[243] (thus highlighting the value of non-wage benefits). To close down enterprises and throw workers out of their jobs would, it is feared, cause great social unrest.[244] As Barrington Moore, Jr. points out, "[u]rban workers resemble a praetorian

240. *Cf.* Davis, *Chinese Social Welfare: Policies and Outcomes*, 1989 CHINA Q. 577, 581 (noting that Chinese welfare policy "defines most social welfare goods as rewards to job statuses").

241. *See, e.g.*, Gong, *supra* note 171 at 36 (threats); Li & Hu, *Nanchang fasheng cesha qiyejia an* [Enterprise Manager Stabbed in Nanchang], Fazhi ribao [Legal System Daily], Sept. 30, 1988, at 1; Zhang, *Changping jianchayuan yu qiye faren daibiao qianding baohu xieyi* [Changping Procuracy Signs Protection Agreement with Enterprise Legal Person Representatives], Fazhi ribao [Legal System Daily], Sept. 30, 1988, at 1 (workers forcing their way into director's house to eat and drink); Li, *Qiyejia beihai xianxiang baoguang* [Attacks on Enterprise Managers Come to Light], FALÜ YU SHENGHUO [Law and Life], No. 2, 1989, at 10 (several incidents, including one of a discharged worker who hacked a director to death, shouting, "I'll teach you to reform!").

242. *See* SOPG, *supra* note 167, at 17-18, 33, 40, 47, 50, 62, 71, 77, 92, 97, 100, 105, 129; *see also* Gong, *supra* note 171, at 36; Li, *supra* note 186, at 3.

243. *See* Interview with Chen Qianchang, Director, Wuhan Chemical Factory, Sept. 11, 1988.

244. When the Shenyang government sought to apply its own bankruptcy regulations to collective enterprises, it discovered that the number of candidates for closing was too large. Fearing social disruption, it settled on three enterprises to serve as examples. *See* Qiao, *Fangbao chang de "baopoxing" shiyan* [The "Explosive" Experiment at

guard for socialism, and it is risky to discipline the praetorian guard."[245]

The work unit is crucial not only to those under it but also to the government above it, which depends on it to exercise control over society. The work unit holds the personal dossiers (*dang'an*) of its members. These dossiers follow citizens through life and contain all the information the state wishes to know. Letters of introduction from the work unit are often needed for travel or access to all but the most public facilities. Family planning policy is enforced through the work unit, whose permission is needed to marry.[246] Closing down enterprises would mean large numbers of citizens without work units. Citizens unattached to work units are the *rônin* of urban China and are able to some extent to escape government control, since that control is so often exercised through the workplace. Without an effective system of social control based on some other principle — for example, residency — the government simply cannot sever large numbers of workers from an enterprise. Bankruptcy in China is thus something like nuclear weaponry: it is rational only in the threatening, not in the use.

For the government to effectuate any law that contemplates a fundamental change in the nature of the urban work unit is virtually impossible. In contemplating closing down enterprises and punishing workers by unemployment, the Bankruptcy Law simply ensured its own impotence.

D. Summary

Why are the many rules against exactions ineffective? The institutional addressee of the rules is local government. The rules are instructions to would-be exacters. They are not instructions to some enforcement institution on how, for example, to distinguish legitimate from illegitimate exactions when handling complaints. They do nothing to alter the power relationship between institutions making exactions and those subject to them. Thus, when a rule says that an enterprise has the "right" to refuse to pay, this is an instruc-

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the Explosion Prevention Equipment Plant], RENMIN WENXUE [People's Literature], No. 4, 1987, at 82.

245. B. MOORE, JR., AUTHORITY AND INEQUALITY UNDER CAPITALISM AND SOCIALISM 99 (1987).

246. *See, e.g.*, the letter from a 24-year-old worker to the Legal Adviser column of the Legal System Daily, where he complains that although the Marriage Law says he may marry at twenty-two, his factory says he must wait until he is twenty-five. Violation of the factory rule can lead to a fine or dismissal. The Legal Adviser's reply is that although technically he has the right to marry immediately, the factory's rule is reasonable and understandable and he should wait. *See* Letter to the Editor, *Changgui yu guofa xiang dichu, gai zhixing nei yige?* [When There Is a Conflict Between Factory Rules and State Law, Which Should Be Implemented?], Fazhi ribao [Legal System Daily], Sept. 27, 1988, at 4.

tion to the would-be exacter not to ask twice. There is no system that can protect the enterprise wishing to refuse.

The rules come from the top of the hierarchy: the State Council. The State Council cannot keep track of what goes on in every enterprise, and lower levels of government, who must actually enforce the rules, have an interest in the revenue from exactions. While there is interest-driven enforcement — afflicted enterprises have standing to make complaints — the victims of exactions are usually reluctant to take action because the combination of large discretion and monopoly power in the supply of important goods and services held by local governments makes it difficult to prevent retaliation.

The rules on hiring and firing by enterprises are more complex. The institutional addressee — the party that is supposed to "obey" — is on the one hand the enterprise's DIC. The rules tell it to give enterprise management a freer hand. On the other hand, the rules (and the accompanying commentary) are also addressed to the Party committee within the enterprise. For this reason, the 1986 Director Regulations, the 1986 Party Organization Regulations, and the 1986 Enterprise Congress Regulations were all jointly issued by the State Council and the CCP Central Committee. The Party committee has real power that can be curbed only by voluntary restraint under instructions from superior Party organs. This explains why so many documents stressing that the enterprise Party committee was to play a smaller role in management came from the Party itself. Finally, it explains why the Lanzhou Municipal Party Committee could later issue measures dictating that enterprise managers had to defer to the enterprise Party committee. Finding that an important promulgator is the Party center and that an important addressee is the enterprise Party committee suggests that the Party disciplinary system will be a key part of the implementation of the rule.

What makes the Bankruptcy Law unusual is that its primary institutional addressee is the courts. However, this fact also accounts for the Bankruptcy Law's apparent dormancy. As noted earlier,[247] there is no shortage of creditors or debtors, yet there are remarkably few reports of enterprises actually being declared bankrupt under the law and having their assets sold to satisfy creditors. The courts and the bankruptcy law apparently are simply irrelevant.[248]

247. *See supra* notes 237 to 239 and accompanying text.

248. The claim made here is an educated guess. I am confident that creditors are not successfully bringing bankruptcy proceedings in Chinese courts against debtors. Whether this is because they are being turned down by courts unwilling or unable to enforce the law or because they are not going to courts in the first place is unclear. My guess, supported by informal conversations with Chinese colleagues, is that creditors

The main problem with the bankruptcy law is simply its lack of fit with the Chinese economic and social order. Like the rule purporting to give enterprise managers the absolute right to veto the departure of workers, it mandates the impossible. The government is not going to allow large numbers of enterprises to be shut down just because the country happens to be going through a recession. Those who are owed money will simply have to wait until the next economic upturn. Even if the mission of the Bankruptcy Law were in principle achievable, it would run up against the question of the power of courts to implement it. In their correct state of institutional development, courts simply are not up to the task of deciding the fate of large collectivities and putting hundreds or thousands of workers out of work. The next Part explores this claim more fully.

VI. RELEVANT INSTITUTIONAL FEATURES OF CHINESE SOCIETY

Part V looked at specific examples of legal rules affecting enterprise incentives and why they were often ineffective. This Part examines some specific institutional features of Chinese society that affect the whole spectrum of legal rules.

A. Weakness of Courts

Any incentive structure premised on protection of rights and enforcement of law by Chinese courts as currently constituted is problematic. The ability of Chinese courts to enforce legal standards is severely limited for several reasons. First, judges may simply lack the education necessary to do the job competently. Second,

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don't even bother with courts because they know (or believe) that it will be no use. "[L]ocal governments and enterprises in the present system have the right to 'refuse to pay back'. . . ." Fan, *supra* note 234, at 25. Creditors thus adopt strategies ranging from sit-ins on the debtor enterprise's doorstep to kidnapping and hostage-taking. *See Guangdong's Illegal Arrest and Detention Cases Rise*, in SWB/FE, May 9, 1990, at B2/1.

Of course, it could be that enterprises, under a soft budget constraint, simply don't care if debts are not repaid promptly. Yet one of the problems for which the bankruptcy law was explicitly promoted as a cure was the indefinite deferral of repayment by debtors. *See* Cao, *Dui pochan qiye yao youge fagui* [There Needs To Be a Law for Bankrupt Enterprises], BAN YUE TAN [Fortnightly Discussion], No. 5, 1986, at 40, *translated in* JOINT PUBLICATIONS RESEARCH SERVICE, CHINA: ECONOMIC AFFAIRS, June 19, 1986, at 32, 32; Gu & Wang, *Woguo jingji faren de caichan zeren fanwei* [The Scope of the Property Responsibility of Economic Legal Persons in Our Country], FAXUE JIKAN [Jurisprudence Q.], No. 2, 1984, at 39, 43; Jiang, Liu & Zhen, *Lun pochan fa* [On Bankruptcy Law], in JINGJI TIZHI GAIGE ZHONG DE RUOGAN MINFA WENTI [Several Issues of Civil Law in the Reform of the Economic System] 168, 190 (R. Tong ed. 1985); Wang, *Lun shixing zhongguo shi de qiye pochan zhengdun zhidu* [On the Implementation of a Chinese-Style Enterprise Bankruptcy and Reorganization System], JINAN XUEBAO (ZHEXUE SHEHUI KEXUE) [Journal of Jinan University (Philosophy and Social Sciences)], No. 1, 1986, at 32, 36.

even if judges have enough education to do the job, they may be corrupt or partial and unwilling to render a correct judgment. Third, even if judges are able and willing to render a correct judgment, their decision may be overridden by higher authorities within the court. Fourth, the court as a whole — not just the individual judges who hear cases — is subject to numerous outside pressures and is particularly vulnerable to local government direction. Fifth, any judgment needs to be enforced, yet the courts are short on autonomous enforcement powers.[249] If a recalcitrant party is local, the court needs the cooperation of other institutions, such as the local Party and government, the police, and the banks. If the judgment is against a "foreign" party — one outside the immediate territorial jurisdiction of the court — then enforcing the judgment can be exceedingly difficult. This part will address each of these obstacles in turn.

1. Lack of Education

Many of China's judges and other legal officials have little or no professional training in law.[250] Judicial ignorance of the law is particularly devastating in a system such as China's because so few ways exist to remedy it. Chinese judicial procedure is basically inquisitorial, leaving a great deal of initiative to the judge instead of to the parties and their lawyers. Just finding the applicable law can be an impossible task. Laws and regulations are promulgated by a bewildering variety of governmental and quasi-governmental bodies, and no comprehensive and up-to-date indexes are available.[251] Indeed, it is *illegal* for individuals to compile collections of laws and regulations.[252] No regular system of case reporting exists that

249. This problem is, of course, hardly unique to China. For a classic American case, *see Ex parte Merryman*, 17 F. Cas. 144 (C.C.D. Md. 1861) (No. 9,487). In that case, Chief Justice Roger Taney was confronted by the simple refusal of military authorities, acting under orders from President Lincoln, to obey a writ of habeas corpus: "I have exercised all the power which the constitution and laws confer upon me, but that power has been resisted by a force too strong for me to overcome." *Id.* at 153.

250. *See supra* notes 87-96 and accompanying text.

251. An egregious example of the problem of keeping track is reported in Ao, *Bei lengluo de xin de "zhian guanli chufa tiaoli"* [A Cold Shoulder to the New "Security Administration Punishment Regulations"], Fazhi ribao [Legal System Daily], Jan. 17, 1989, at 2. One of China's most important statutes is the Security Administration Punishment Regulations (SAPR), which designate a variety of public order offences and grant to the police the authority to try and punish offenders. The SAPR were first promulgated in 1957, *see* 1957 [July-Dec.] FGHB 245, but were reissued with substantial revisions in 1986, *see* 1986 FGHB 151. The reissue was accompanied by a substantial, even unavoidable publicity campaign. Nevertheless, several authoritative law books published in 1987 and 1988 continued to refer to the 1957 SAPR as the current statute, and one even recommended that it be revised to fit current conditions.

252. *See Fagui huibian bianji chuban guanli guiding* [Rules on the Administration of the Compilation and Publication of Collections of Law and Regulations], 1990 STATE COUNCIL BULLETIN 579, art. 5, *translated in* SWB/FE, Aug. 14, 1990, at 26.

would allow judges to see how other courts had handled similar problems.[253] Quite often there will simply be no statutory rule directly on point, or there may exist contradictory rules. In these cases, guessing how an untrained and ill-educated judge will choose to decide the issue is impossible, and parties have no sense of what sorts of arguments should or should not count.

2. Corruption

Official corruption is a serious problem in China[254] — indeed, it was one of the grievances that sent the people of Beijing and other cities into the streets in the spring of 1989[255] — and it extends to the judiciary.[256] The extent of corruption, however, cannot be quantified in a rigorous way which would provide meaningful comparative perspective. The number of news stories is a function of the government's wish to publicize the problem, not necessarily of its magnitude. In the absence of reliable data, the existence of this obstacle to law implementation can be noted, but specification of its degree is not possible.

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253. The Supreme People's Court does publish the Supreme People's Court Bulletin, a periodical containing directives, interpretations, and cases (generally lower court decisions thought to be particularly instructive). In addition, judges no doubt have access to case reports that are not publicly available. I know of no publication, however, that indexes cases by subject matter, and thus case reports are not as useful as they might otherwise be. A useful introduction to the role of the Supreme People's Court Bulletin is Liu, *"Judicial Review" in China: A Comparative Perspective*, 14 REV. SOCIALIST L. 241, 246-250 (1988).

254. For a sampling of Chinese and foreign assessments, see Burns, *China's Governance: Political Reform in a Turbulent Environment*, 1989 CHINA Q. 481, 490 n.33 and sources cited therein; Kristof, *Leaders in Beijing Bar Their Kin from Using Family Ties for Profit*, N.Y. Times, July 29, 1989, at A1, col. 1; Leung, *Greased Palms Lubricate Wheels in China*, Wall St. J., July 20, 1989, at A10, col. 1; Xinhua [New China News Agency], *Chief Procurator[:] Anti-Corruption Struggle will Be "Long" and "Arduous"*, *translated in* SWB/FE, Nov. 28, 1989, at B2/1. "What can you do—it's the kids," Chinese officials reportedly said (more or less) to remonstrating officials of the Reagan administration when explaining that they were powerless to stop freelancing children of high officials from selling missiles to Iran and Saudi Arabia. *See* Butterfield, *Under Deng, Running China Has Become a Family Affair*, N.Y. Times, July 2, 1989, § 1, at 1, col. 4.

255. *See* WuDunn, *50,000 Lift Their Voices for Change*, N.Y. Times, May 16, 1989, at A12, col. 4. In a survey of 2,348 residents of 33 cities conducted in 1987 by a branch of the Chinese Academy of Social Sciences, respondents expressed a high degree of dissatisfaction with official corruption. *See* Burns, *supra* note 254, at 489.

256. *See, e.g.*, Ren, *supra* note 78, at 120; Zheng, *Zuigao renmin fayuan gongzuo baogao* [Supreme People's Court Work Report], *reprinted in* Zhongguo fazhi bao [Chinese Legal System News], Apr. 23, 1986, at 2, 3 (report delivered to 4th Session of 6th National People's Congress, April 8, 1986); *Heilongjiang People's Court Work Report* (in Chinese), Heilongjiang ribao [Heilongjiang Daily], Mar. 19, 1990, at 7, *translated in* FBIS, May 10, 1990, at 80, 81; Kyodo News Agency, *Bribery Attempts on Court Officials Increase*, in FBIS, July 28, 1989, at 27; *Law Officials Trample on Law*, China Daily, July 21, 1989, at 3.

3. Overriding of Judge's Decision Within the Court

Courts at all levels have as part of their structure an Adjudication Committee headed by the president of the court.[257] It is the highest decision making body within the court as an institution.[258] Official policy states that "judicial independence" means not that the particular judge or judges hearing the case should be independent from outside pressures (*i.e.*, senior judges in the same court), but at most that the court *as an institution* should be free from outside pressures.[259] The Adjudication Committee has the power, among other things, to override the decision of the judges who actually hear the case and conduct the trial and to order them to enter a different decision.[260] Reports in the legal press indicate that in

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257. *See* Court Organization Law, *supra* note 75, art. 11.

258. Article 8 of the Court Organization Law does not actually say this in so many words, giving the Adjudication Committee the authority only to "discuss" important and difficult cases. Nevertheless, it is quite clear from other Chinese sources that this is so. A 1957 Supreme People's Court directive, for example, said:

> The Adjudication Committee is an adjudicatory organ of the people's court. It has the right to directly make the final decision on the substantive resolution of cases. Because at present the [role of the] Adjudication Committee generally is never publicized, the verdict in cases that have been discussed by it should still be signed by the personnel constituting the collegial panel that tried the case in question.

Zuigao renmin fayuan guanyu jing shenpan weiyuanhui taolun de anjian zai panjue shu shang ruhe shuming wenti de fuhan [Reply on the Supreme People's Court on the Question of How to Sign Verdicts in Cases Discussed by the Adjudication Committee], July 23, 1957, in ZHONGHUA RENMIN GONGHEGUO FALÜ QUANSHU [Compendium of the Laws of the People's Republic of China] 286 (1989). In addition, the Criminal Procedure Law provides clearly that when cases are submitted to the Adjudication Committee for discussion, "[t]he collegial panel [that tries the case] shall carry out the decisions of the adjudication committee." *Zhonghua renmin gongheguo xingshi susong fa* [Criminal Procedure Law of the People's Republic of China], 1979 FGHB 87, art. 107. Evidently sensitivities about the Adjudication Committee's role have declined: a legal journal recently carried a short piece urging that verdicts in cases actually decided by the Adjudication Committee should be signed by its members. *See* He, *Shenpan weiyuanhui jueding de anjian caipan shu ying you shenpan weiyuan shu ming* [Verdicts in Cases Decided by the Adjudication Committee Should Be Signed by Committee Members], FAXUE [Jurisprudence] (Shanghai), No. 10, 1990, at 29. For academic criticism of the power of the Adjudication Committee, see the sources cited in *infra* note 266.

259. "The view that the collegiate bench [*heyi ting*] and the trial judge [*shenpan yuan*] can independently adjudicate and that the chamber president and the court president can have no say in the matter [*bu neng guowen*] is in opposition to the principle of independent adjudication by courts mandated by the laws of our country." *Zuigao renmin fayuan yuanzhang jiang hua tan renmin fayuan duli shenpan wenti* [Supreme People's Court President Jiang Hua Discusses the Issue of Independent Adjudication by the People's Courts], Zhongguo fazhi bao [Chinese Legal System News], May 29, 1981, at 1. For a study of the theory and practice of judicial independence in the first decade of the People's Republic, see Cohen, *The Chinese Communist Party and "Judicial Independence": 1949-1959*, 82 HARV. L. REV. 967 (1969).

260. The relationship between the local Party authorities, the Adjudication Committee, and the individual judge(s) hearing a case can be expressed as follows. The Party committee has the right, and even the duty, to concern itself with the work of the

many courts the Adjudication Committee routinely decides cases, with the result that "those who try the case do not decide it, and those who decide the case do not try it" (*shenzhe bu pan, panzhe bu shen*).[261]

4. Vulnerability to Outside Pressures

Judges can be threatened with various unpleasant consequences if they do not decide as the threatener wishes. I shall look here at only one kind of vulnerability with a specific institutional basis, that is, the power of the local Party and government to dictate to courts how they shall decide cases. The local Party tends to judicial matters through its Political-Legal Committee (*zheng-fa weiyuanhui*).[262] This Committee has traditionally been in charge of the police, the procuracy, the courts, other aspects of judicial administration, and civil affairs. The Committee often is headed by the leader of the local police or of the local Party and government.[263]

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court and to make suggestions. It has the actual power, but not the right, to order the court to make a particular decision. The Adjudication Committee has both the right and the actual power to order individual judges hearing a case to make a particular decision.

261. Sun, *Dangqian fayuan shishi duli shenpan de zuli ji duice* [Obstacles and Solutions to the Implementation of Independent Adjudication by Courts Today], XIANDAI FAXUE [Modern Jurisprudence], No. 1, 1989, at 44, 45. For other criticisms of the current role of the Adjudication Committee, see Xiong, *"Wei shen xian pan" bixu kefu* [[The Practice of] "Decision Before Trial" Must Be Overcome], FAXUE [Jurisprudence] (Shanghai), No. 4, 1990, at 31; Li, *Gai "xian ding hou shen" wei "xian shen hou ding"* [Change "Decision Before Trial" to "Trial Before Decision"], FAXUE YANJIU [Legal Studies], No. 2, 1990, at 39; Wang, *Shenpan weiyuanhui dingan ying yu gaibian* [The System of the Adjudication Committee Deciding Cases Should Be Changed], ZHENGZHI YU *falü* [Politics and Law], No. 1, 1989, at 24.

262. According to *Zhonggong zhongyang guanyu chengli zheng-fa weiyuanhui de tongzhi* [Notice of the Central Committee of the Chinese Communist Party on the Establishment of Political-Legal Committees] (Central Committee Doc. No. 5, 1980), the Political-Legal Committee, inter alia, "guides [*zhidao*] the work of the various political-legal departments" (this would include courts) and "properly disposes of important and difficult cases." This document, not to my knowledge publicly available, is cited in *Zhonggong zhongyang guanyu jiaqiang zheng-fa gongzuo de tongzhi* (Chinese Communist Party Central Committee Notice on Strengthening Political-Legal Work), Jan. 13, 1982, *reprinted in* ZHONGGONG NIANBAO 1983-84 [Yearbook of Chinese Communism 1983-84] 8-3, 8-6 (Taipei 1984) [hereinafter 1982 Political-Legal Notice].

The central CCP Political-Legal Committee was renamed the Political-Legal Leading Group in 1988 as part of a move to reduce its influence. Following the crisis of May and June, 1989, it has been revived. *See* Lam, *Legal, Security Apparatus to Be Strengthened*, South China Morning Post (Hong Kong), Apr. 4, 1990, at 10, *reprinted in* FBIS, Apr. 4, 1990, at 22. Similar changes in status occurred at the local level. *See Change in Status of Legal Organs in Sichuan*, in SWB/FE, Feb. 13, 1990, at B2/1 (announcing retransformation of county- and provincial-level Political-Legal Leading Groups back into Committees and associated rise in status).

263. *See* Zhao et al., *supra* note 96, at 5. In the words of one article in the Chinese legal press:

> There now exists universally, throughout the country, a situation

A common practice in China is for local Party secretaries or Party committees to review and approve the disposition of cases by courts.[264] This was the concrete manifestation of the principle of Party leadership. The official theory now is that Party leadership is to be exercised at the level of legislation or general policy making, not in the adjudication of specific cases.[265] But breaking old habits has proved difficult. A CCP Central Committee directive of 1982

> whereby the [local] politics and law committees exercise unified leadership over the public security bureau, the procuracy, and the courts — and whereby the chief of the public security bureau holds, concurrently, the post of Secretary of the Politics and Law Committee. As a result of this practice, the procuracy's exercise of its legally-prescribed power of supervision over the public security organs frequently degenerates into an empty formality.

Guanyu jiancha jiguan tizhi gaige de jidian yijian [Some Suggestions Regarding the Structural Reform of Procuratorial Organs], FAXUE JIKAN [Legal Studies Q.], No. 1, 1987, at 70, 71, *quoted in* NEWS FROM ASIA WATCH: TORTURE IN CHINA 6 (July, 1990) If the procuracy cannot question the acts of the public security organs, it is unlikely that the courts can do any better.

264. In 1959, a model judge wrote:

> When cases I have handled required arresting and sentencing, had a relatively strong policy nature, or involved village or cooperative cadres, I asked instructions from the Party committee both before and during the process of handling the cases, and afterward I reported to the Party committee. . . .Whenever the Party committee gave me instructions, I conscientiously studied and thoroughly implemented them.

Liu, *Realizations from my Adjudication Work* (in Chinese), ZHENGFA YANJIU [Political-Legal Studies], No. 1, 1959, at 48, *quoted in* J. COHEN, THE CRIMINAL PROCESS IN THE PEOPLE'S REPUBLIC OF CHINA: 1949-1963, 501 (1968). The practice described above, far from being irregular, has in fact been given a name: *shuji pi'an* [approval of cases by the [local Party] secretary]. *See generally* Chiu, *Structural Changes in the Organization and Operation of China's Criminal Justice System*, 7 REV. SOCIALIST L. 53, 59-61 (1981) (discussing the persistence of the "shuji pi'an" system).

265. *See* Zhang, *Quxiao dangwei shenpi anjian* [The Abolition of the Examination and Approval of Cases by the Party Committee], ZHONGGUO BAIKE NIANJIAN [China Encyclopedic Yearbook] 189 (1981). One Chinese writer stated the theory as follows:

> As everyone knows, our country's constitution was drafted and discussed by the drafting committee formed by responsible comrades of the Party centre and personages from all walks of life. In addition, it was passed by the organ of supreme state power, the National People's Congress, embodies the will of the entire Party and people, and represents the common interests of all the people. If state laws are subject to the decisions of any level of the Party, then in truth the collective interests of the entire Party and all the people are subject to the interests of a locality or a small group. This is an absurd theory and a dangerous practice.

Dong, *Shei ye bu neng jü yu falü zhi shang* (Nobody Can Be Above the Law), SHEHUI KEXUE [Social Science], No. 1, 1980, at 7, 10. In 1980, President of the Supreme People's Court Jiang Hua was quoted as saying: "When the Party committee strengthens its leadership over political-legal departments, it is mainly in the area of line, principles, and policy. It is not necessary to examine and approve specific cases." *Baozheng fayuan yi fa duli shenpan, feichu dangwei shenpi anjian zuofa* [Guarantee the Independent Adjudication of Cases by the Courts in Accordance with the Law; Abolish the Practice of the Party Committee Examining and Approving [Decisions in] Cases], Renmin ribao [People's Daily], Aug. 25, 1980, at 1. Mr. Jiang also referred to a 1979 CCP Central Committee document instructing Party committees not to override the rules of the Criminal Law and the Criminal Procedure Law. *Id.*

strongly suggested that Party committees would remain heavily involved in court work and that local Party leaders would personally consider all important cases.[266] Indeed, as recently as February 1988 the *Legal System Daily* saw the need to report in a major article that the Beijing Municipal Party Committee had "in recent years" (*jinnianlai*) stopped the practice of approving individual cases.[267] Despite government denials — one semi-official newspaper in Hong Kong, for example, denounced reports of Party influence over court decisions as "nonsense"[268] — reports in the Chinese legal press itself make clear that the practice continues in many places: "[Although the Political-Legal Committee] is in name an organ of coordination among the police, procuracy, and courts, it is in reality the organ of leadership for all three. It involves itself directly in adjudication work, and in some cases decides the verdict itself."[269]

Judges may find themselves out of a job if they do not do as they are told by the Political-Legal Committee or other local power holder. The formal power of appointment and dismissal of court personnel is lodged in the local People's Congresses. In practice, however, they act as rubber stamps for the local Party organizational department.[270] The real power is in the hands of the local Party leadership.[271] "This personnel power exercised by a small

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266. *See* 1982 Political-Legal Notice, *supra* note 262.

267. *See Beijing shiwei jinnianlai yi bu zai shenpi anjian* [Beijing Party Committee in Recent Years No Longer Examines and Approves Cases), Fazhi ribao [Legal System Daily], Feb. 1, 1988, at 1.

268. *See* Ye, *Let the World Learn About the Facts — Interview With Department Concerned in Beijing on Wang Juntao's Case* (in Chinese), Ta Kung Pao [Hong Kong], Dec. 9, 1990, at 1, *translated in* FBIS, Dec. 10, 1990, at 20, 21. The *Ta Kung Pao* is for all intents and purposes a Chinese government mouthpiece.

269. Sun, *supra* note 261, at 44.

270. *See* Zhao et al., *supra* note 96, at 3, 5. According to one report,

> In some areas of Heilongjiang [Province], when the Party organizational department recommends or nominates cadres for appointment to or dismissal from government organs, it often first issues the appointment order within the Party and the nominee takes up his post. Several months later, by way of "taking care of the formalities," it reports the appointment to the People's Congress Standing Committee at the same level for discussion and approval.

Zhi fa bu yan mianmian guan [An All-Around Look at Lack of Rigor in Implementation Law], Fazhi ribao [Legal System Daily], Feb. 25, 1988, at 1.

271. *See Gaishan zhifa de keguan tiaojian* [Improve the Objective Conditions for the Implemetation of Law], Fazhi ribao [Legal System Daily], Apr. 14, 1989, at 1. One county Party secretary is reported to have expressed this view at a meeting of political-legal cadres:

> All of you sitting here, I ask you — you, the court president: if I hadn't put your name up, could you serve? You, the chief procurator: if I hadn't put your name up, could you serve? You, the public security chief: if I hadn't put your name up, could you serve? If you ask me, none of you could serve!

Fang, *Renmin fayuan zai guojia jigou zhong de diwei* [The Position of the People's

group of leaders hangs like the sword of Damocles over those who would do things according to law."[272] Thus, "[i]f the court insists on handling things according to law and disposes of certain cases in ways not satisfactory to these leaders, some of them will use their power to arbitrarily reassign the court's leadership."[273].

Some Chinese analysts, noting the local government's power over personnel, have suggested putting the entire court system under vertical leadership.[274] The Supreme People's Court is reported to be drafting regulations to reform the court personnel system, and basic-level court presidents may be placed directly under provincial leadership.[275] This will not be enough to solve the problem, however. Even where there is no question of actually dismissing or transferring judges, local governments are often able to exert pressure on courts through their control over court finances and material supplies as well as other court personnel.[276] A recalcitrant court could find its clerical help transferred elsewhere, its automobile unrepaired, its electricity supply frequently interrupted, and its budget cut. One writer quoted the saying, "If you eat from his bowl, he has control; if you're eating his rice, you take his advice (*duan shei de wan, shou shei guan; chi shei de fan, wei shei gan*)."[277] This sort of power will remain with local governments until courts have an inviolable source of funds and vital goods and services are available on the market and not solely through government allocation.

Courts in the Structure of the State], FAXUE ZAZHI [Jurisprudence Magazine], No. 4, 1985, at 15, 16.

272. Zhao et al., *supra* note 96, at 5.

273. Shi, *Shenpan zhong difang baohu zhuyi de chengyin ji duice* [Local Protectionism in Adjudication: Causes and Countermeasures], FAXUE [Jurisprudence] (Shanghai), No. 6, 1989, at 15.

274. *See, e.g., id.* at 17.

275. *See* Zhao et al., *supra* note 96, at 5; *Gaishan zhifa de keguan tiaojian*, *supra* note 271, at 1. In his report of March, 1989 to the National People's Congress, Supreme People's Court president Ren Jianxin indicated that the Judicial Officers Law [*faguan fa*] was in the drafting stage and would deal with tenure. *See* Ren, *Zuigao renmin fayuan gongzuo baogao* [Supreme People's Court Work Report], Renmin ribao [People's Daily], Apr. 9, 1989, at 2, *translated in* FBIS, May 2, 1989, at 83, 89-90.

276. *See* Shi, *supra* note 273, at 16; *Gaishan zhifa de keguan tiaojian*, *supra* note 271, at 1. In discussing the difficulty of ruling against administrative organs, an official of the Beijing Intermediate People's Court said: "The personnel, finances, and supplies of the courts are subject to pervasive control by administrative organs. If you annul the decision of an administrative organ today, you will have problems when you need its help in doing something tomorrow." *See Minzhu he fazhi jianshe de zhongyao buzhou — xingzheng susong fa zuotanhui jishu* [Roundtable Discussion: The Administrative Litigation Law: An Important Step in the Establishment of Democracy and Legality], ZHONG-WAI FAXUE [Chinese and Foreign Legal Studies] (Jiang ed.), No. 3, 1989, at 37, 40.

277. *Cited in* Shi, *supra* note 273, at 16. This is a free translation. The same point is made in Sun, *supra* note 261, at 44.

5. Obstacles to Enforcement

Enforcing court judgments against any determined defendant, to say nothing of a well-connected and politically powerful defendant, is frequently difficult. An impressionistic view is provided by a report to the Standing Committee of the Sixth National People's Congress. In Heilongjiang province, only 10% of court judgments are "conscientiously implemented"; 20% are implemented in a "relatively conscientious" way. In half the cases, a few results are achieved, but a "relatively large degree of difficulty" is encountered in implementation; and 20% of court judgments are implemented "fairly poorly."[278]

Slightly more precise statistics are also available. Of final judgments in cases involving economic disputes, 20% could not be enforced in 1985 and 1986. In 1987 the figure rose to 30%.[279] The president of the Liaoning Provincial Higher People's Court reported that in 1988, judgments were not executed in over 4,100 cases (24.5% of the total).[280] The people's court of Songjiang County, Shanghai, rendered final judgments in 203 economic dispute cases in 1988. Of these, judgments in 130 cases (64%) had not been executed as of March 1989.[281] The court of Baokang County, Hubei, reported a 1987 implementation rate of 84.2% (1,030 out of 1,224 cases) where implementation involved property.[282] On the

278. *See* Yan, *Liu-jie ren-da meiyou gufu quanguo renmin de weituo, wulun shenme wenti dou ying yi duoshu ren liyi wei zhun* [The Sixth NPC Did Not Let Down the People of the Whole Country; In All Problems the Interest of the Majority Should Be the Criterion], Fazhi ribao [Legal System Daily], Jan. 21, 1988, at 1. Chinese statistics, especially judicial statistics, must be used with extreme caution. For example, a statistical table in a book on mediation puts a precise number on lives saved (i.e., murders averted) through mediation: 104,976 in 1982 and 88,331 in 1983. *See* GUO, XU, LI ET AL., RENMIN TIAOJIE ZAI ZHONGGUO [People's Mediation in China] 36 (1986), *cited in* Palmer, *The Revival of Mediation in the People's Republic of China: (1) Extra-Judicial Mediation*, in YEARBOOK ON SOCIALIST LEGAL SYSTEMS 1987, at 219, 226 n.23 (W. Butler ed. 1987). The real lesson of the numbers offered here is simply that Chinese writers consider the problem of implementation of court judgments to be serious.

279. *See* Shi, *supra* note 273, at 15 (citing Zheng Tianxiang's report to the 1st session of the 7th National People's Congress). These figures should be considered rough estimates, not precise statistics. Moreover, a high number of non-implemented judgments is not necessarily a sign of court weakness. Such numbers often seem to include cases where the defendant is simply bankrupt and cannot pay. *See, e.g.*, Ding, *Dui 42-jian wei zhixing de jingji anjian diaocha pouxi* [Investigation and Analysis of Forty-Two Cases of Economic Disputes Where the Judgment Was Not Implemented], FAXUE ZAZHI [Jurisprudence Magazine], No. 3, 1989, at 42.

280. *See* Xinhua [New China News Agency], *Failure to Enforce Laws "Grave Problem"* (in Chinese), *translated in* FBIS, Mar. 28, 1989, at 15.

281. *See* Xu & Liu, *Songjiang xian fayuan "shen zhi jian gu"* [The Songjiang County Court Pays Attention to Both Adjudication and Execution], Fazhi ribao [Legal System Daily], Mar. 4, 1989, at 1.

282. *See* Wang, *Baokang fayuan anjian zhixing bu tuo bu ya* [Baokang Court Implements Judgments Without Delay and Without Backlogs], Fazhi ribao [Legal System Daily], Aug. 3, 1988, at 2.

other hand, the court in Anyang County in Henan reported an overall implementation rate of only 10%.[283] While these figures vary widely across the country and are not very reliable, they do suggest a problem of some magnitude.

Why is it so difficult to execute judgments? First, there are few penalties for refusing to obey a court order.[284] Chinese courts have no contempt power, and refusing to obey a court order is not a crime. Article 157 of the Criminal Law[285] makes criminal a refusal to carry out a judgment if the refusal is by means of threats or violence. This covers the person who interferes with the actions of others carrying out a judgment, but does not cover the person who is ordered to do something and simply does not do it.[286] Article 77 of the Civil Procedure Law empowers the court to fine or detain those who "have a duty to assist in execution" of civil judgments and refuse to do so, but this may not refer to the actual object of the judgment, who is usually called "the executee" (*bei zhixing ren*).[287] One report discusses a man sentenced under the Criminal Law to one year's imprisonment for refusing to carry out a judgment, but no details are provided as to whether he used threats or violence.[288]

Second, courts often lack sufficient bureaucratic clout to enforce their judgments against administrative units. Any clout they have comes from the bureaucratic rank of individual judges. Although courts and governments at any given level are supposed to be equal, court presidents generally have a lower bureaucratic rank than the chief executive of the government at the same level.[289] This means, for example, that the latter has access to some documents from the center that the former cannot see. That a lower-level official from one bureaucracy should be able to give orders to a

283. *See* Zhang, *Ju bu zhixing fayuan panjue yao fu falü zeren; anyang xian fayuan panchu li tiansheng tuxing yi nian* [Those Who Refuse to Implement Court Judgments Must Bear Legal Responsibility: Anyang County Court Sentences Li Tiansheng to One Year's Penal Servitude], Fazhi ribao [Legal System Daily], Aug. 3, 1988, at 1.

284. *See* Ding & Chen, *Shilun qiangzhi zhixing lifa* [A Tentative Discussion on Legislation Regarding Compulsory Execution], FAXUE ZAZHI [Jurisprudence Magazine], No. 5, 1989, at 38, 39.

285. *Zhonghua renmin gongheguo xing fa* [Criminal Law of the People's Republic of China], 1979 FGHB 48 [hereinafter Criminal Law].

286. One writer proposes that the crime of contempt of court [*mieshi fating zui*] be added to the Criminal Law. Even this proposal, however, does not appear to cover all deliberate refusals to carry out court judgments and orders. It suggests punishing refusal to carry out court judgments "in a way that shows contempt for the court [*yi mieshi fating de fangshi*]." Zhao, *Zai xing fa zhong ying zengshe mieshi fating zui de tiaokuan* [A Provision Should Be Added to the Criminal Law Criminalizing Contempt of Court], XIANDAI FAXUE [Modern Jurisprudence], No. 1, 1989, at 56.

287. *Zhonghua renmin gongheguo minshi susong fa (shixing)* [Civil Procedure Law of the People's Republic of China (for Trial Implementation)], 1982 FGHB 133.

288. *See* Zhang, *supra* note 283, at 1.

289. *See* Fang, *supra* note 271, at 15; Hsia, The Concept of Judicial Independence 9 & n.3 (unpublished paper 1986).

higher-level official from another is alien to the way China functions.[290] A low-status judge does not have the prerogative to disobey, much less to command, a higher-status official. As one county Party secretary is reported to have said, "Tell me what matters more: official rank or the law? I can definitely tell you, rank matters more. Law is made by man; without man, how could there be law? Without man, how could law matter at all? That's why I say that rank matters more."[291]

Third, the cooperation of local authorities is needed. Judicial independence is not much use if it results in nothing more than the issuance of a piece of paper. The enforcement of local court judgments may be supported by local authorities, if only because a judgment they opposed would likely not be issued in the first place. Nevertheless, courts are reluctant to move with force and authority against the truly recalcitrant defendant. In one case, an old man and his wife transferred their house to another, and then wanted it back so they could give it to their son. To accomplish their purpose, they simply reoccupied the original house. The new owner took them to court and won both on first trial and on appeal. The defendants, however, refused to move out on the grounds that they were old. Fearing they would commit suicide, the court eventually ruled that they could stay until they died, at which time the court's judgment would take effect. The writer reporting this case criticizes the court, but demonstrates the identical attitude when he says that where execution would "genuinely cause difficulty," one should consider an "appropriate postponement."[292]

Local authorities are also reluctant to enforce laws and execute judgments against local enterprises for fear of driving business away. "People fear only that their own region will be too strict in enforcing the law, binding their own hands and feet, with the result that they suffer economically and lose out in competition."[293] This rationale does not apply, of course, when the judgment settles a dispute between two enterprises of equal local importance.

The greater enforcement problem occurs with the execution of "foreign" judgments, those that apply outside the jurisdiction of the local government. The enforcement of such judgments is essentially a voluntary matter for the local authorities. Local courts in China are considered in fact, although not in law, to be simply arms of

290. *See generally* K. LIEBERTHAL & M. OKSENBERG, *supra* note 47, ch. 4 (discussing characteristics of the structure of state power).

291. *See* Fang, *supra* note 271, at 16.

292. Su, *Fayuan de panjue zai mouxie difang nan yi zhixing* [Court Judgments Are Difficult to Implement in Certain Places], Fazhi ribao [Legal System Daily], Jan. 3, 1989, at 4.

293. Ma, *Xi "difang sifa baohu zhuyi"* [An Analysis of "Local Judicial Protectionism"], Fazhi ribao [Legal System Daily], June 30, 1989, at 3.

local government. Courts are dependent on local government for their financing, and their personnel serve *de jure* at the pleasure of the local People's Congress and *de facto* at the pleasure of the local Party organization.[294] This sets the stage for the conflict of two principles. A court, wherever located, is by law empowered to issue a judgment binding on anyone, provided it has proper jurisdiction. In the Chinese political system, however, County A in Province X cannot tell County B in Province Y what to do any more than the citizens of Del Mar, California, can declare Groton, Connecticut, a nuclear-free zone. Because of the identification of courts with local governments, their judgments are subject to the latter principle, not the former.

Local authorities often oppose the enforcement of foreign judgments.[295] Under economic reform, localities are more dependent than in the past on their own resources, and local enterprises form the revenue base for local governments.[296] Thus, protecting the financial health of local enterprises is important. The President of the Supreme People's Court complained about this phenomenon:

> Some localities—mainly Party and government leaders at the basic level—demand that when the court passes judgment, it be favorable to the party from the locality. If it is not, they accuse the court of "embracing outsiders" (*gebozhou wang wai guai*). If a court from outside the locality rules against a local party in a suit, requiring that party to bear economic liability, to pay a debt, or to compensate for economic loss, certain leaders of the locality will obstruct the implementation of the court's judgment.[297]

The financial contract system, under which localities are obliged to turn over a fixed amount of revenues to the center each year and may keep the rest,[298] has made local authorities even less willing to permit resources to flow out of the jurisdiction. Since local governments are usually the primary claimants on the enterprise's income, they bear the loss when their enterprise pays out to a foreign party.[299]

Because local courts commonly rule against outsiders, even the most upright local authorities would have good reason to be suspicious of the impartiality of a foreign judgment against a local enter-

294. *See* Kraus *supra* note 86 and accompanying text.

295. *See* Mu & Liu, *Shei zai wei beigao chongdang houtai?* [Who Is Backing Up the Defendant?], Fazhi ribao [Legal System Daily], Apr. 5, 1988, at 3.

296. *See* Ding & Chen, *supra* note 284, at 38; Shi, *supra* note 273, at 16.

297. Shi, *supra* note 273, at 15 (citing a speech made by Supreme People's Court president Ren Jianxin in October, 1988). Ren's predecessor made the same complaint in almost identical terms (and using the same colloquial expression) in April of 1986. *See* Zheng, *supra* note 256, at 3.

298. *See supra* notes 56-57 and accompanying text.

299. *See* Ding & Chen, *supra* note 284, at 38.

prise. They would naturally be reluctant to help enforce it. Sometimes foreign court personnel will actually make a trip (at the winner's expense)[300] to the loser's district to execute the judgment. But without the cooperation of local authorities, foreign court personnel are simply strangers in a strange land. They have no connections, no authoritative letters of introduction, and no power.[301] Obtaining local court cooperation can be exceedingly difficult if the local authorities are dead set against it. Contracts across jurisdictions can be unenforceable.[302] In one case, a local court refused to help enforce a foreign judgment despite two specific orders from the Supreme People's Court to do so.[303]

In the face of this protectionism, local governments have begun to make treaties pledging to protect each other's enterprises as their own. Shanghai, for example, is reported to have signed agreements "on the protection of the legitimate rights and interests of enterprises" with nine provinces.[304] These treaties can play a useful role as long as the parties have an interest in continued cooperation, and are more practical than the usual pious exhortations to local authorities.[305] They are, however, essentially unenforceable.

B. The Role of the Enterprise's Administrative Superior

The discussion above has shown that courts cannot be relied upon to implement government policy. The only authority that can genuinely tell the enterprise what to do is the DIC.[306] Thus a great deal of lawmaking, while apparently granting rights to and establishing duties on the enterprise, is in fact aimed at the DIC. In

300. The propriety of the subsidizing by the parties of various court expenses is discussed in Lu, *Fayuan fu waidi ban'an ying you dangshiren chengdan chailü fei* [Parties Should Pay the Travel Expenses When Courts Go to an Outside Locality to Handle a Case], FAXUE [Jurisprudence] (Shanghai), No. 11, 1990, at 28.

301. *See* Henan sheng xinxiang shi zhongji renmin fayuan [Henan Province Xinxiang City Intermediate Level People's Court], *Shuli quanguo fayuan yipanqi sixiang, jiji xiezhu waidi fayuan gaohao zhixing gongzuo* [Take the Courts of the Whole Country as a Single Chessboard; Actively Assist Courts from Other Areas to Do Implementation Work Well], Fazhi ribao [Legal System Daily], Apr. 5, 1988, at 3.

302. *See* Yao, *Bingchu difang baohu zhuyi, yi fa weihu qiye quanyi* [Get Rid of Local Protectionism; Uphold the Rights and Interests of Enterprises According to Law], Fazhi ribao [Legal System Daily], Apr. 14, 1989, at 3.

303. *See* Chen Shibin, *Dawu xian fayuan jianchi difang baohu zhuyi, tuoyan san nian ju bu xiezhu zhixing waidi panjue* [Dawu County Court Persists in Local Protectionism; After Delaying Three Years, Still Refuses to Assist in the Execution of an Outside Judgment], Fazhi ribao [Legal System Daily], June 4, 1988, at 1.

304. *See* Yang, *"East-West Dialogue" in China — the Strategy of Unbalanced Economic Development on the Mainland in Perspective* (in Chinese), LIAOWANG [Outlook] (overseas edition), No. 9, 1989, at 5, *translated in* FBIS, Apr. 10, 1989, at 37, 39.

305. See, for example, the "solution" proposed by one writer: "The best way of solving the problem [of court judgments not being implemented] is for the relevant units and personnel to truly do things according to law." Su, *supra* note 292, at 4.

306. On the DIC, see *supra* note 100.

recognition of the practical capabilities of the DIC and the lack of alternatives, some economists have suggested that the future role of the DIC should be the legal supervision of the enterprise.[307] Unfortunately, while the DIC has the practical power to enforce state policy, it often lacks the will to do so.

First, the DIC is bureaucratically entwined with the enterprise. Key enterprise personnel are appointed by the DIC and have their career path within the DIC.[308] The prestige of the DIC is linked with the number and size of enterprises under its control.[309] Thus, close organizational and personal ties bind the enterprise with the DIC. The DIC has a paternalistic interest in the success of "its" enterprises, which are more like subsidiaries than objects of regulation. Second, locally-run state enterprises are an important source of revenue for local governments, whether funds are extracted through profit remittances or through taxes.[310] Hence, local governments are reluctant to take or enforce measures that would hurt the ability of local enterprises to supply funds to local government.[311]

In short, while the DIC has a great deal of practical power over enterprise operations, it can also use its governmental power to gain special benefits for the enterprise or to shield it from harmful regulation. Thus, DICs try to persuade financial and tax authorities to give preferential treatment to "their" enterprises. "They would like to let the enterprises in their systems enjoy lower quotas and exceed them easily, to add lustre to themselves."[312] They also can effectively exempt their enterprises from the rules of the Environ-

307. This was suggested by the Wuhan Economic Commission in SOPG, *supra* note 167, at 10.

308. *See* Li & Wu, *supra* note 235, at 27-28.

309. As two Chinese writers observe, "[DICs] are unwilling to see their reputation tarnished and their property suffer losses due to bankruptcy of their subordinate enterprises. Still less does an administrative leadership choose to have its performance devalued by the higher authorities as a result of bankrupting of subordinate enterprises". *Id.* at 19.

310. *See* discussion on page 120, *supra*.

311. Lü, *supra* note 33, at 53.

312. Zhang, *How Should the State Oversee Its Assets?*, China Daily, Oct. 19, 1987, at 4, col. 1; *see also* Walder, *The Informal Dimension of Enterprise Financial Reforms*, in JOINT ECONOMIC COMMITTEE, CHINA'S ECONOMY LOOKS TOWARD THE YEAR 2000, VOL. 1: THE FOUR MODERNIZATIONS, S. Prt. No. 149, 99th Cong., 2d Sess. 630, 643 (1986). A particularly egregious example of such solicitude for subordinate enterprises occurred with the cancellation of an exhibition of shoddy goods originally planned for mid-December, 1987 by the Ministry of Light Industry. *See Xinhua* [New China News Agency] report, *translated in* SWB/FE, Dec. 15, 1987, at B2/4. The Ministry began with good intentions, but backed down in the face of internal opposition and strong pressure from the enterprises under its jurisdiction. As one reporter noted, the Ministry seemed unable to decide whether it represented consumers or enterprises — "[b]ut due to their connections with factories, it is more likely for the ministry [and its staff] to show partiality to factories." Wu, *Fine Start and Poor Finish* (in Chinese), *translated in* SWB/FE, Dec. 17, 1987, at B2/1; *see also* Wu, *Viewing the Difficulties Facing State*

mental Protection Law[313] and protect enterprises that do not pay their taxes.[314] The difficulty of making rules stick sabotages a legal regime aimed at modifying enterprise behavior. When the action of an enterprise threatens unwelcome consequences, instead of ceasing the action, the enterprise has the option of using its ties to government to mitigate the consequences.

The local government is in the dual position of enterprise owner/manager and law enforcer. Where these two interests conflict, law enforcement is generally the loser because it offers no concrete benefits to local government.[315] Thus, the congruence of interests of the enterprise and its DIC means that legal supervision will often be nothing more than self-supervision, with predictable consequences.

C. Summary

1. Significant Power Lies in Local Government

Applying national standards consistently to all enterprises will be extremely difficult. The close ties of state enterprises to local government mean that regulation of enterprises is perceived by local governments as an intrusion on local prerogatives and resisted as such. Where local authorities do not implement the law, remedies are essentially nonexistent.[316] This is part of a general difficulty that exists in China of applying legal standards to the acts of government authorities. As one observer complained, there is an attitude that

> law applies only to the resolution of problems between individuals; it regulates only the common people. It is not so effective

Organs in Changing Functions After the Aborted Exhibition of Inferior Products (in Chinese), *translated in* SWB/FE, Dec. 18, 1987, at B2/4.

313. *See* Jin, *supra* note 122, at 9.

314. "This is because some extra-budgetary enterprises are 'petty cash boxes' for various local departments and units. With the backing of those in charge, they pay no tax and no dividend." Tang & Li, *Protect the Tax Collectors' Rights to Collect Taxes* (in Chinese), Renmin ribao [People's Daily], Sept. 7, 1985, at 1, *translated in* JPRS-CPS, Nov. 11, 1985, at 24. In one case, an enterprise manager was arrested by the county procuracy for criminal failure to pay taxes, but was openly supported by the enterprise's two DICs and the city government. *See* Fu, *Qinghai yi changzhang toushui zuize nantao; sheng mouxie bumen tanhu dizhi zhifa* [Qinghai Factory Director Cannot Escape Responsibility for Tax Evasion; Some Provincial Departments Provide Shelter and Obstruct Implementation of the Law], Renmin ribao (haiwai ban) [People's Daily (overseas edition)], Dec. 7, 1988, at 4. Local governments have also been notoriously lax in collecting the Banquet Tax, promulgated by the State Council in September, 1988. *See* Gong, *Sheli yanxi shui neng yizhi gongkuan chi-he ma?* [Can the Imposition of the Banquet Tax Put a Stop to Eating and Drinking With Public Funds?], FAXUE [Jurisprudence] (Shanghai), No. 2, 1989, at 35; Huang, *"Yanxi shui" he yi cheng kongwen* [Why the "Banquet Tax" Has Become Meaningless], Fazhi ribao [Legal System Daily, Apr. 19, 1989, at 1.

315. *See* Li, *supra* note 94, at 14.

316. *See id.*

> when it comes to mass organizations, to say nothing of state administrative organs. It is precisely for this reason that there can exist the strange phenomenon of state administrative organs being made a party to a case accepted by a court and yet refusing to appear.[317]

Of course, these state entities have more than just an attitude problem. The attitude of administrative organs would quickly change if they suffered any undesirable consequences as a result of refusing to appear in court, such as losing by default and suffering some consequence thereby. Because these consequences do not occur, obedience by administrative organs to court-enforced law remains essentially voluntary.

Administrative disobedience to court orders sheds an interesting light on an old debate: are attitudes toward law best explained by culture and history, or is it more fruitful to look for causes in specific institutional arrangements existing here and now?[318] Law is as law does, and in this context, law does as courts do. If law is what courts administer, and if courts cannot touch administrative organs, then recourse to history or culture to explain contemporary attitudes toward law is unnecessary. People believe that law applies only to the common people for the unsurprising reason that it is by and large true.

2. Courts Cannot Be Used to Resolve Rule Conflicts

No system of rules made by human beings can be perfectly consistent. Contradictions are bound to arise. Courts are one of the few institutions with the formal authority to resolve disputes cutting across regional and bureaucratic lines. As they do not have the actual power to do so, however,[319] there exists no authoritative and effective way to resolve inconsistencies and contradictions in legislation. This has two results. First, the most well intentioned local authorities may be unable to enforce a rule because it is inconsistent with another rule. They simply do not know which rule they are supposed to follow.[320]

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317. Li, *Falü zhi "guan" laobaixing ma?* [Does Law Govern Only the Common People?], Zhongguo fazhi bao [Chinese Legal System News], Oct. 30, 1985, at 2.

318. This debate has been carried on with some vigor in the field of Japanese law. For the traditional view of culture as a sufficient explanation for Japanese attitudes, see, inter alia, Kawashima, *Dispute Resolution in Contemporary Japan*, in LAW IN JAPAN: THE LEGAL ORDER IN A CHANGING SOCIETY 41 (A. von Mehren ed. 1963) and Amaya, *Wa no rinri to dokkin hô no ronri* BUNGEI SHUNJÛ, Dec. 1980, at 176, *translated and abridged as Harmony and the Antimonopoly Law*, JAPAN ECHO, No. 1, 1981, at 85.

319. See the discussion on page 119, *supra*.

320. *See* Ji, *Bumen guizhang he difang guizhang de xiaoli dengji* [The Hierarchy of Validity of Departmental Regulations and Local Regulations], FAXUE ZAZHI [Jurisprudence Magazine], No. 6, 1988, at 17.

Second, the choice between conflicting or inconsistent rules may be made simply by the happenstance of which enforcing authority possesses greater physical power. Great confusion was caused recently when the State Council issued contradictory transportation regulations. One regulation authorized local highway departments to establish toll stations; the other reserved this right to public security organs. The contradiction was resolved in Shanxi not through a process of legal argumentation, but rather by the actions of the police, who forcibly removed toll stations set up by the highway departments.[321]

3. Administrative Enforcement Leads to Policy Distortion

Administrative organs are not, of course, free to go completely their own way. They receive policy directives from superior levels and are supposed to carry them out. However, an inevitable amount of distortion exists. A pervasive problem in any authority system is ensuring that commands from the top are carried out at the lower levels of the system that interact directly with the object of regulation. Control over the lower levels decreases as the organization becomes larger and the distance increases between policy makers at the top and policy implementers and enforcers at the bottom. The difficulties encountered by Chinese policy makers at the center in seeing their directives implemented are well known. In general, the greater the number of layers between policy making and policy implementation, the greater the amount of "noise" which will interfere with implementation.

The key advantage of court-enforced policy (*i.e.*, "law") over bureaucratically implemented policy is that, if the system works properly, it reduces to a minimum the number of layers between policy making and policy implementation. Parties come before the court with a specific dispute which the court has the authority and power to resolve. The court resolves this dispute by direct reference to the original text of policy issued by the relevant policy maker. This text could have been directly formulated and approved by the central authorities. When a court resolves a dispute, therefore, only one intermediate layer exists between the central policy makers and the regulated parties.

Clearly, certain conditions must be present for the actual system to approximate the ideal. First, the system should maximize the probability that judges will make a good faith effort to apply central policy as the policy makers would want it to be applied. Central control over judicial tenure and working and living conditions would work in this direction. Second, courts must actually be

321. *See* Wang, *"Nei zhan" he shi xiu?* [When Will the "Civil War" End?], Fazhi ribao [Legal System Daily], June 27, 1989, at 4.

able to enforce their decisions. The resources of the center can be used to further courts' enforcement efforts. In short, both the judgment and the power of the courts need to be as independent as possible of local authorities and subordinate organs of the central policy making organs. Finally, the central policy must be expressed in sufficient detail for it to be enforceable with a fair degree of uniformity so that there is no need for further interpretation beyond the minimum required in any case. All interpretation should be in the hands of a bureaucracy whose personnel are directly controlled by the central policy making organ.[322]

One reason why distinguishing policy intended for bureaucratic implementation from policy intended for judicial implementation is difficult in China is that Chinese courts do not have the features outlined above. They are not capable of functioning as policy implementing bodies one level removed from policy making bodies. Court personnel are beholden to local authorities both for their position and for the power to enforce their decisions. To the extent that a court renders judgment independent of the opinions of local organs of state power, it will find those judgments difficult to implement. As a result, central legislation in China often takes the form of general policy directives. Typically, a piece of central legislation will contain a provision saying that implementing regulations are to be worked out later either by a subordinate State Council ministry or commission or by local governments. The making of these implementing regulations provides intermediate bodies of the state bureaucracy with the opportunity to bend and deform central policy according to their own priorities. When hearing concrete cases, courts often must defer to the opinions of local authorities, again providing the opportunity for "noise" to interfere with the implementation process.

Thus, the weakness of courts makes it impossible to use "law" as a means of circumventing the authority leakage inherent in the transmission of directives down bureaucratic ranks. Nevertheless, the attempt to strengthen legal institutions should be understood as an attempt to do precisely that.

VII. CONCLUSION

This Article attempts to describe the institutional framework

322. Montesquieu's classic separation of the judicial power from the legislative power arises from a concern for justice, not a concern for efficient policy implementation. The concern for justice demands that legislation be general, and that the legislature not be allowed to interfere in specific cases. From the standpoint of policy implementation, however, the only reason not to ask the legislature to judge *every* case is that it would be swamped by the work. Therefore, one establishes a body of bureaucrats who are specially trained in reaching the conclusion the legislature would have reached had it thought about the matter.

and tools available for shaping enterprise behavior in China subject to a policy imperative of economic reform. It has argued that economic reform, as envisioned by the Chinese leadership, requires a particular kind of rule making and rule application. This rule making and application is characterized by generality and should be understood in opposition to the traditional system of ad hoc bargaining between individual enterprises and their superiors. The problem with a system of general rules is that there is no system of institutions in China willing and able to enforce them. First, there is a chicken-and-egg problem. In the absence of economic reform, economic activity does not take place on a level playing field. Thus, applying general rules without taking individual differences into account is not only seen as unfair, but actually is so. Moreover, it may be counterproductive as well, if efficient enterprises that nevertheless lose money find themselves in trouble. However, economic reform will not get off the ground as long as the principle of particularism reigns.

Second, making general rules stick implicates important questions of political power. It means drastically weakening the power of some institutions to grant exemptions and building institutions that can enforce the rules. Courts have seemed the natural candidate for the task because of their sweeping formal authority and their ability to keep to a minimum the amount of noise in policy transmission. They are not, however, capable of carrying it out as currently structured. Power in China flows within bureaucratic systems, not across them. Rules that purport to operate horizontally across bureaucracies are essentially alien to the system and are difficult to enforce. Without the creation of an enforcement institution that transcends the traditional system of state power, any law promoting fundamental economic reform that purports to be generally applicable is unlikely to be effective.

While the legal system has undergone significant reforms in the last decade, in a number of crucial areas it remains unable to perform the task of enforcing the rules of economic reform. First, no evidence exists to suggest that courts have more real power now than they did a decade ago. The observance of court judgments for many institutions remains essentially voluntary. Yet establishing a system where courts would have real power involves grasping some very thorny political nettles. Second, courts remain essentially the creatures of the level of government that appointed their personnel. They cannot be used to overcome the obstacles to reform caused by local protectionism and particularism when they are part of the very structure causing the problem.

The prominence of local and regional centers of political power on the list of obstacles to economic reform in China may shed light on the question of the proper role of the state in the establishment

of economically efficient social institutions. Recent writing in law and economics has attacked the "legal-centralist" view, attributed to scholars from Hobbes to Calabresi, that the state is the exclusive creator of property rights.[323] Instead, these writers say, property rights may arise "anarchically out of social custom" and "from the workings of nonhierarchical social forces."[324]

The debate may turn out to be about what the participants mean by "rights." Just how compulsory must the corresponding duty be before we will find that a "right" exists? A study of norms established spontaneously in the whaling industry hardly disproves the legal-centralist thesis when the writer concedes that the system broke down as economic pressures led some whalers simply to defect.[325]

If we adopt a strong definition of "rights," however, the Chinese case suggests that the spontaneous-rights thesis, while not wrong, has limits in a complex economy. Efficient economic organization does not just happen: powerful political forces which are opposed to it can be overcome only by more powerful political forces. State intervention is just as necessary to a complex market economy as it is to a planned economy. Local state power made the commerce clause necessary; federal state power is needed to enforce it.

323. *See* Ellickson, *A Hypothesis of Wealth-Maximizing Norms: Evidence from the Whaling Industry*, 5 J. L. ECON. & ORG'N 83 (1989); R. Zerbe, The Development of Institutions and the Joint Production of Fairness and Efficiency in the California Gold Fields (Right Makes Might) (May 8, 1990) (unpublished manuscript).

324. *See* Ellickson, *supra* note 323, at 83.

325. *See Id.* at 95 n.39.