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ENTERPRISING CHINA

Business, Economic, & Legal Developments since 1979

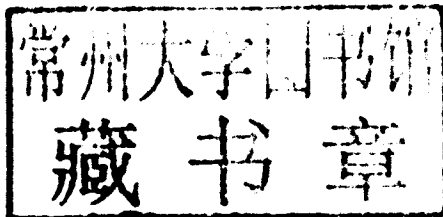


LINDA YUEH

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Developments since 1979

Linda Yueh



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■ PREFACE

China's transition from a centrally planned economy to a more market-oriented one has been remarkable. Business in China has accordingly been transformed. This book covers the evolution of business developments in contemporary China. Using both economic and legal reforms as the overall framework, it analyses the marketization of industry in China during the thirty-year reform period.

This interdisciplinary approach will contribute to the analysis of business development in China, which can best be understood within a complex framework of laws, politics, and economic reform aims. The distinctive feature of the book is that it views both domestic enterprise reform in China and the evolving treatment of foreign firms in the context of both corporate laws and economic policies.

The book leads the reader through the complex interaction between economics, law, and politics in shaping the business environment in China. It also looks ahead to how business is likely to evolve as economic and legal reforms speed up in the twenty-first century, notably with China's increasing global integration.

And, this volume also incorporates case studies to provide industry-specific analysis as illustrations of the overall macroeconomic and legal developments in China's economy during its first thirty years of reform. The book includes twelve original business case studies integrated into one volume which are great teaching tools and add facts and colour to an issue.

A number of case studies are also kindly contributed by Kun-Chin Lin of King's College, London, Jonathan Story of INSEAD in Paris, and Sanzhu Zhu of the School of Oriental and African Studies (SOAS) in the University of London. Their expertise adds greatly to this volume. Finally, valuable research assistance has been provided by Yan (Bonnie) Cheng, Xiao Mei Li, Ryan Manuel, and Jing Xing, which is appreciated.

■ ABBREVIATIONS

2SLS	two-stage least squares
3G	third generation
3SLS	three-stage least squares
ABC	Agricultural Bank of China
ADB	Asian Development Bank
ADR	alternative dispute resolution
AMC	asset management company
ASEAN	Association of Southeast Asian Nations
ATC	Agreement on Textiles and Clothing
AVIC	Aviation Industries of China
BAIC	Beijing Automotive Industry Corporation
BAIHC	Beijing Automotive Industry Holding Corporation
BCS	Budgetary Contract System
BIS	Bank for International Settlements
BOC	Bank of China
CAAC	Civil Aviation Administration of China
CAS	Chinese Academy of Sciences
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CDB	China Development Bank
CEO	chief executive officer
CEPA	Closer Economic Partnership Arrangement
CIC	China Investment Corporation
CICC	China International Capital Corporation
CIETAC	China International Economic and Trade Arbitration Commission
CIRC	China Insurance Regulatory Commission
CJV	cooperative joint venture
CNOOC	China National Offshore Oil Corporation
CNPC	China National Petroleum Corporation
CNTIC	China National Textile Industry Council
COE	collectively-owned enterprise
CPC	Communist Party of China

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CPI	consumer prices index
CRS	Contract Responsibility System
CSRC	China Securities Regulatory Commission
DRC	Development Research Centre
DSB	dispute settlement body
DSU	dispute settlement understanding
EPZ	Export Processing Zone
ETDZ	Economic and Trade Development Zone
EJV	equity joint venture
FAA	US Federal Aviation Administration
FAW	First Auto Works
FDI	foreign direct investment
FIE	foreign-invested enterprise
FSB	Financial Stability Board
FSF	Financial Stability Forum (later re-named Financial Stability Board)
FTA	free trade agreement
FTC	foreign trade corporation
FTZ	Free Trade Zone
G20	Group of 20 major economies
GDP	gross domestic product
GLS	generalized least squares
GM	General Motors
GSM	Global System for Mobile Communications
HMT	Hong Kong, Macao, Taiwan
HRS	household responsibility system
HTDZ	High-Technology Development Zone
ICBC	Industrial and Commercial Bank of China
ICFAI	Institute of Chartered Financial Analysts of India
ICT	Information and Communication Technology
IFI	international financial institution
IHT	<i>International Herald Tribune</i>
IMF	International Monetary Fund
IOC	International Olympic Committee
IPR	intellectual property rights
IPO	initial public offering
IRR	internal rate of return
IV	instrumental variable

JV	joint venture
LDC	least developed country
LLC	limited liability company
LLP	limited liability partnership
LSE	London Stock Exchange
M2	monetary aggregate
M&A	mergers and acquisitions
MFA	Multi Fibre Agreement
MII	Ministry of Information Industry
MOF	Ministry of Finance
NBECZ	National Border and Economic Cooperation Zone
NBS	National Bureau of Statistics
NIE	Newly Industrializing Economy
NOC	national oil company
NPC	National People's Congress
NPL	non-performing loan
NYSE	New York Stock Exchange
OCC	Open Coastal City
OECD	Organization for Economic Co-operation and Development
OLS	ordinary least squares
OPC	Open Port City
OTC	over the counter
PBOC	People's Bank of China
P/E ratio	price-to-earnings ratio
PPP	purchasing power parity
PRC	People's Republic of China
QC	quality control
QDII	Qualified Domestic Institutional Investors
QFII	Qualified Foreign Institutional Investors
R&D	research and development
RBS	Royal Bank of Scotland
RMB	renminbi or Yuan
SAIC	Shanghai Automotive Industry Corporation
SAR	Special Administrative Region
SASAC	State-owned Assets Supervision and Administration Commission
SC	State Council
SCB	state-owned commercial bank

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SEC	US Securities and Exchange Commission
SETC	State Economic and Trade Commission
SEZ	Special Economic Zone
SIP	share issue privatization
SME	small and medium-sized enterprise
SOAS	School of Oriental and African Studies
SOE	state-owned enterprise
SURE	seemingly unrelated regression estimation
SWF	Sovereign Wealth Fund
T&C	textile and clothing
TAIC	Tianjin Automobile Industry Corporation
TFP	total factor productivity
TRIPs	trade-related aspects of intellectual property rights
TRM	transitional review mechanism
TVE	township and village enterprise
VAR	vector autoregressive model
VAT	value-added tax
VW	Volkswagen
WFOE	wholly foreign-owned enterprise
WTO	World Trade Organization

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1 Introduction

One of the most notable features of China's growth in the three decades since market-oriented reforms were introduced in 1979 is the development of a corporate sector that has produced companies which are among the largest and fastest growing ones in the world—with firms such as the computer company, Lenovo, and ICBC (Industrial and Commercial Bank of China) becoming part of the global business landscape. Against a backdrop of transition from an economic system that was almost entirely state-owned as recently as the early 1980s, it is all the more remarkable, and underpins much of China's successful economic development.

The transformation of China's industrial sector from one run by the state to a marketized or nearly marketized one is driven not only by economic policies but also by legal reforms that have occurred alongside. These economic policies and institutional reforms have contributed to the development of a market economy out of a previously centrally planned economic system where the state dictated output and prices as well as nearly all other aspects of supply and demand. China's successful development is often referred to as a 'paradox,' as the market has seemingly developed without a sound legal foundation. Instead, economic policies and permissive attitudes towards decentralized regions experimenting with market forces have seemingly managed to instil incentives that have propelled growth.

Although it is certainly true that the legal system is incomplete in that much of it has been developed only since the 1990s and claims of imperfect enforcement of the extant laws mar the usual praise associated with China's development, China has also undertaken a large number of legal reforms that have evolved with the market. For instance, anticipation of an increase in mergers and acquisitions (M&A) activities with greater market opening after the 2001 accession to the World Trade Organization (WTO) prompted the passage of a M&A law in 2003. In other areas, laws were passed to facilitate investment, such as the Law on Chinese–Foreign Equity Joint Ventures, which was the first corporate law of the reform period promulgated in July 1979. It heralded the start of the influx of foreign direct investment (FDI) that has been a notable part of China's success in becoming a global exporting power in the span of only a couple of decades. Without such a law, foreign investors, not accustomed to investing without legal principles governing their rights, would not have chosen China as the destination for their funds to the same extent.

The interplay between legal and economic reforms, therefore, is crucial to understand as part of the assessment as to how the market has developed in China. This is not to attribute the success of market development simply to laws, but rather, this book takes the perspective that laws and regulations which solidify market foundations and property rights have been enacted alongside economic policies that together enable the development of a market system in China. Neither perfect nor complete, the laws promulgated in China nevertheless create property rights (real estate, intellectual property rights such as patents), establish contracting relationships (Chinese–Foreign joint ventures), and govern markets (regulators such as the China Securities Regulatory Commission). Therefore, this volume posits that legal and economic reforms interacted to create, support, and govern the market in China. In some areas, legal reforms have been more important than in others, notably in attracting FDI, while arguably less so in others, for example in developing privately-owned firms, which have arisen as the state has withdrawn from large segments of the economy, thus opening up opportunities for entrepreneurs to enter.

The theme of the book is that the development of the corporate industrial and services sector has followed the approach of China's broader economic and legal transformation: gradual, policy-led, market-oriented reforms are undertaken, resulting in (and on rare occasions, sequenced with) complex economic system changes and legal reform. This book will cover the evolution of the corporate sector in China from the late 1970s to the present under this framework. Importantly, the book will bring together an analysis of contemporary Chinese business developments with the more broadly known story of China's economic and, to a lesser extent, its relationship to legal reforms.

The main theme of the book is that developments in the business sector are very closely intertwined with China's economic and legal reforms—all of which have been undertaken gradually, and premised on the overriding policy command which seeks social and political stability. The book will argue that the evolution of enterprises in China, and Chinese enterprises globally, will depend on both the continuing domestic economic *and* legal reform process and China's ever-deepening engagement with the global economy and with international capital markets. An understanding of contemporary business developments in China will also allow observers to anticipate further evolution in this sector, particularly as China moves towards an increasingly marketized internal economy with a greater degree of global integration as it grows ever closer in economic might to the major economies of the world.

1.1 Structure of the book

After this introductory chapter, the second chapter analyses Chinese legal and economic reforms since 1979 to identify the key contributors and policies which have led to the transformation of the enterprise sector from one dominated by state-owned enterprises (SOEs) and collective enterprises (such as township and village enterprises or TVEs) into a diverse corporate sector comprising not only SOEs and TVEs but also privately-owned and foreign-invested enterprises (FIEs). The role of legal as well as economic reforms will be highlighted to provide a fuller picture of the development of the corporate sector. The third chapter assesses the interplay between law and markets to explain the China ‘paradox’ of having achieved significant growth whilst having a notably weak legal system when institutional development is thought to be a prerequisite to economic development. A complex interaction between formal laws and informal institutions was intertwined with markets in a way that is not dissimilar to what most countries contend with at China’s stage of economic development, but with the added complication that a communal property state existed for most of the period.

Following from these overviews, the next chapters will analyse the four major enterprise sectors in China: SOEs, TVEs, private firms, and foreign firms. These chapters will investigate the ways in which legal and economic policies were enacted to further the state’s goals in each of these sectors. For instance, the move to reform SOEs involved adopting a form of privatization known as ‘share issue privatization’ with the aim of corporatizing state-owned firms and making them into shareholding companies that can eventually become privately owned with stock sold to the public. To achieve this, the Company Law of 1993, along with the creation of the stock markets in the early 1990s, was enacted to lay a market-recognized foundation for the policy intent of the corporatization of SOEs.

The motivations behind the policies may differ among these ownership types, but the state used both law and institutional reform to mould and shape the development of the sector. For SOEs, it appears that the state used laws to legitimize the policy enactments to restructure but not privatize all of the state firms. For the collective sector, laws were often enacted post hoc in response to economic necessity but without fundamental ownership reform, as rural TVEs in particular served to maintain industry in the lagging segment of the Chinese economy. In other words, TVEs—a lingering hybrid form of enterprise—appear to serve multiple purposes that suit the overall partial economic transition approach of China. For private firms, it is an entirely different matter. Hampered for the most part by laws that favoured SOEs and collectives as well as foreign firms, private firms arose despite the legal obstacles. Laws pertaining to the private sector tended to be enacted ex post,