
EMERGING LEGAL ISSUES IN CHINA

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Good evening, ladies and gentlemen. It is a great pleasure and honor to participate in this Symposium.

The Symposium is entitled “Emerging Legal Issues in China.” It is a proper title. Since China began its economic reform program in the late 1970s and early 1980s, a tremendous amount of legal and business advancement has taken place. Today, China boasts an impressive body of laws and regulations: Company Law (1993; amended 2005),¹ Labor Law (2004),² Unified Contract Law (1995),³ Insurance Law (1995; amended 2002),⁴ Guarantee Law (1995),⁵ Partnership Law (1997),⁶ Securities Law (1998; amended 2005),⁷ Trust Law (2001),⁸ Securities Investment Fund Law (2003),⁹ Procedures for Administration of Commercial Franchising (2004),¹⁰ Regulations for the Administration of Direct Selling (2005).¹¹ These are just a few important ones that were enacted in the last thirteen years.

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¹ Company Law (promulgated by the Standing Comm. Nat’l People’s Cong., Dec. 29, 1993, amended Dec. 25, 1999) (P.R.C.), <http://www.cclaw.net/download/companylaw.asp>.

² Huawei Lin et al., *New Labor Laws in China for 2004*, STAY CURRENT (Paul, Hastings, Janofsky & Walker LLP), Dec. 2003, available at http://www.paulhastings.com/tmpdocs/33384.pdf?wt.mc_ID=33384.pdf. The new laws include Decree Nos. 16, 17, 18, and 19, by The Ministry of Labor and Social Security (“MOLSS”): MOLSS Decree No. 16, Methods on Social Insurance Inspection; MOLSS Decree No. 17, Methods on the Scope of Work-related Injury; MOLSS Decree No. 18, Provisions on the Scope of Relatives to be Supported of Employees Dying from Work-related Injury; and MOLSS Decree No. 19, Provisions on the One Time Compensation by Units Illegally Employing Employees. *Id.*

³ K.H. Wang and K. Akers, *The New Chinese Unified Contract Law: How Will it Affect Foreign Investors?*, 26 ASIA BUS. L. REV. 79 (1999).

⁴ Insurance Law (promulgated by the Standing Comm. Nat’l People’s Cong., June 30, 1995, effective Oct. 1, 1995) (P.R.C.), <http://www.zgbxb.com.cn/inlaw.htm>.

⁵ Guarantee Law (promulgated by the Standing Comm. Nat’l People’s Cong., June 30, 1995, effective Oct. 1, 1995) (P.R.C.), <http://www.newsgd.com/business/laws/200306120019.htm>.

⁶ Partnership Law (promulgated by the Standing Comm. Nat’l People’s Cong., Feb. 23, 1997, effective Aug. 1, 1997) (P.R.C.), <http://www.cclaw.net/download/partnershiplaw.asp>.

⁷ Securities Law (promulgated by the Standing Comm. Nat’l People’s Cong., Dec. 29, 1998, effective July 1, 1999) (P.R.C.), http://www.novexcn.com/securities_law_99.html.

⁸ Trust Law (promulgated by the Standing Comm. Nat’l People’s Cong., Apr. 28, 2001, effective Oct. 1, 2001) (P.R.C.), http://www.ec.com.cn/pubnews/2004_03_29/200863/1005110.jsp.

⁹ Securities Investment Fund Law (promulgated by the Standing Comm. Nat’l People’s Cong., Oct. 28, 2003, effective June 1, 2004).

¹⁰ Rules for the Administration of Commercial Franchising Operations were issued December 30, 2004. Shirley Xu, *China Opens Its Doors to Foreign Franchisors*, ASIALAW, July-Aug. 2005, available at <http://www.asialaw.com/default.asp?page=14&ISS=17706&SID=525658>.

¹¹ Regulations for the Administration of Direct Selling (promulgated by the State Council, Aug. 23, 2005, effective Dec. 1, 2005) (P.R.C.), <http://www.chinalawandpractice.com/default.asp?Page=1&cIndex=2&SID=4778&M=10&Y=2005>.

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Without adequate laws to regulate the market, companies, and contracts, and without a reliable system of settling disputes, the socialist market economy would be limited in its growth. That is recognized in China and here in the West.

All of this progress is positive and exciting. Yet, twenty-some years of economic reform and market liberalization have brought, along with remarkable success, some new challenges. To meet these new challenges, either a new legal framework needs to be established in certain areas, or the existing legal regimes need to be adjusted in other areas. Hence, this Symposium is important and timely as it takes stock of emerging issues or crises that China faces and explores emerging legal responses.

What are the emerging issues that could seriously derail China from its current path of development and growth? I highlight five areas: the environment, energy, the financial sector, social security, and land policy.

Environment

In the environmental area, without addressing environmental degradation, the big question is: Is there enough water? Water is one of the scarcest resources in China. The country's per capita availability of renewable water resources is only about one-third of the world average.¹² Moreover, water is distributed in a way that is opposite to population distribution: population is densest in the northern half of China and in the eastern part of China, while water is most abundant in the southern and western regions. Therefore, managing this scarce resource is crucial for China's future development. Otherwise, water shortages will become a major obstacle to continued economic growth and social development.

What kind of legal and policy responses are needed to address this challenge? There may be many, and as an amateur China observer, I will just highlight a few. First, China may improve definition and delineation of water use rights. For example, in several states in the western United States, water rights typically include three components: (1) the amount that may be extracted; (2) the amount that may be consumed; and (3) the amount that must be returned to the local water system.¹³ Perhaps China experts can study this established system, and its measures and control mechanisms, to promote water preservation. Second, China can develop a functioning water market in which water users may sell their water rights to allocate water use more efficiently. This, however, will depend on more clearly defined water user rights. Third, China could further strengthen the Water Pollution Control Law,¹⁴ amended in 1996. This would enhance the

¹² GERHARD K. HEILIG, INT'L INST. FOR APPLIED SYS. ANALYSIS, CAN CHINA FEED ITSELF? (1999), available at http://www.iiasa.ac.at/Research/LUC/ChinaFood/index_m.htm; see also Table—Renewable Water Resources in China, available at http://www.iiasa.ac.at/Research/LUC/ChinaFood/data/water/wat_8.htm.

¹³ WORLD BANK, TECHNICAL PAPER NO. 427, INSTITUTIONAL FRAMEWORKS IN SUCCESSFUL WATER MARKETS—BRAZIL, SPAIN, AND COLORADO, USA (1999).

¹⁴ Law on Prevention and Control of Water Pollution (promulgated by the Standing Comm. Nat'l People's Cong., May 1, 1984, effective Nov. 1, 1984, amended May 15, 1996), available at http://www.lehmanlaw.com/lib/library/Laws_regulations/environment/water_pollution.htm.

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law's enforcement power by increasing maximum monetary damage and clarifying criminal liability.

Energy

As China's gross domestic product quadrupled from 1980 to 2000, its energy consumption more than doubled to about 1,300 million tons of coal equivalent.¹⁵ China is now the second largest energy consumer in the world and the largest producer and consumer of coal.¹⁶ Additionally, projections for energy consumption indicate that fuel consumption could double or almost triple by 2020.¹⁷ So the big question remains, is there enough energy?

While searching the world to secure some energy supply, China has started to devote substantial attention to enhancing efficiency in energy use and developing renewable sources of energy. Commensurate with that, China has made significant progress toward improving the national legal and regulatory framework. For example, enactment of the Electricity Law of 1995¹⁸ and related regulations promote energy efficiency and conservation. Amendments to the Mineral Resource Law of 1997¹⁹ are geared to encourage foreign investment in this sector. In the renewable resources area, the Chinese government adopted a Renewable Energy Promotion Law in February 2005 to facilitate China's policy of encouraging energy suppliers to use renewable energy sources.²⁰ The law requires that electricity suppliers meet some of their needs from renewable resources and thereby create demand for such alternative sources of energy. Certainly, regulations need to be introduced to actually implement the policies articulated in the law.

Financial Sector

China's accession to the World Trade Organization ("WTO") brought both opportunities and challenges. According to China's WTO commitments, the banking market will be fully opened to foreign banks by the end of 2006.²¹ In

¹⁵ ENERGY INFO. ADMIN., U.S. DEPT. OF ENERGY, CHINA COUNTRY ANALYSIS BRIEF (2005), available at <http://www.eia.doe.gov/emeu/cabs/china.html>.

¹⁶ *Id.*

¹⁷ CHINESE ACAD. OF ENG'G, NAT'L RESEARCH COUNCIL, PERSONAL CARS AND CHINA 116 (National Academies Press 2003), available at <http://darwin.nap.edu/books/030908492X/html/116.html>.

¹⁸ Electricity Law (adopted at the 17th Meeting of the Standing Comm. Nat'l People's Cong., Dec. 28, 1995, effective Apr. 1, 1996) (P.R.C.), <http://www.chinaembassy.org.in/eng/zgbd/t185949.htm>.

¹⁹ Mineral Resources Law (adopted at the 15th Meeting of the Standing Comm. Nat'l People's Cong., Mar. 19, 1986, and amended in accordance with the Decision of the Standing Comm. Nat'l People's Cong. on Revising the Mineral Res. L. of the P.R.C., adopted at the 21st Meeting of the Standing Comm. Nat'l People's Cong. on August 29, 1996) (P.R.C.), <http://www.chinagate.com.cn/english/2152.htm>.

²⁰ Renewable Energy Law (promulgated by the Standing Comm. Nat'l People's Cong., Feb. 28, 2005, effective Jan. 1, 2006), available at http://www.renewableenergyaccess.com/assets/download/China_RE_Law_05.doc.

²¹ Michael Overmyer, *With China's WTO entry requirements winding down, will 2006 become China's "Year of the Bank"?*, CHINA BUS. REV., Jan.-Feb. 2006, <http://www.chinabusinessreview.com/public/0601/overmyer.html>.

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other words, foreign banks will be allowed to engage in a full range of banking business in China by this year's end.

What's the current situation of the Chinese banking market? Four state-owned commercial banks ("SCBs") dominate the market, while a dozen or so joint-stock commercial banks are trying to increase their market shares.²² Rural credit cooperatives nearly collapsed and are now undergoing fresh reforms. Banking services still focus on traditional deposit-taking and lending activities. Banks generally have low profitability and high non-performing loan ratios.²³

Among the many responses to the reform and restructuring challenge, one is to improve corporate governance at Chinese banks. This would include clarifying the roles and authority of the Board of Directors and Board of Supervisors (e.g., specific guidelines based upon the current Law on Commercial Banks) and permitting shareholder activism. Admission of foreign strategic investors will also help, as has been shown in the restructuring of Bank of China and China Construction Bank.

In the insurance arena, a major development in 2005 was the establishment of an insurance guarantee fund. Through Measures for the Administration of Insurance Guarantee Funds ("Measures"), the China Insurance Regulatory Commission ("CIRC")²⁴ took a first step toward reducing the moral hazard of state public finances. The Measures specify that, in the event of bankruptcy or shutting down of an insurance company with post-liquidation assets insufficient to discharge policy benefits, the CIRC may utilize insurance security funds to provide relief to policy holders or companies that have acquired policies based on a combination of pro rata relief and absolute amount relief.²⁵ With respect to the administration of the insurance guarantee fund, CIRC will open a dedicated insurance guarantee fund account and keep separate accounts for each insurance company. Investments of the premiums are restricted to bank deposits, government bonds and other instruments specified by the CIRC. Investments in equity, real estate, or other types of industrial investment are prohibited in keeping with the very risk-averse mandate of the guarantee fund. In terms of governance, a board of governors will be established with responsibility for supervising the management and use of insurance guarantee funds.

In the capital market area, a major development is the extensive revision of the Securities Law that took effect on January 1, 2006.²⁶ The revised law included several features to further open the securities market, such as issuing and trading

²² China-Britain Business Council, Market Intelligence—Banking System, http://www.cbcc.org/market_intelligence/tlb/banking.html (last visited Sept. 9, 2006).

²³ *Id.*

²⁴ G8 INFO. CTR., UNIV. OF TORONTO, GLOBALIZATION: THE ROLE OF INSTITUTION BUILDING IN THE FINANCIAL SECTOR—THE CASE STUDY OF CHINA (2003), available at http://www.g8.utoronto.ca/g20/20030831_cs_chi.pdf.

²⁵ Joseph J. Norton et al., *Legal Aspects of Depositor Protection Schemes: Comparative Perspective*, International Seminar on Legal and Regulatory Aspects of Financial Stability (Basel, Switzerland, Jan. 21-23, 2002), <http://www.cdic.ca/bin/APEC/ProfNorton-Basel%20Jan%202002.pdf>.

²⁶ Haifeng Wang, *Financing Reforms*, CHINA DAILY BUS. WEEKLY, Feb. 27, 2006, at 5, available at http://www.chinadaily.com.cn/english/doc/2006-02/27/content_524187.htm.

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of derivatives, permitting bank funds to enter the stock market, and leaving the door open to future universal banking.²⁷ It also strengthened investor protection in that securities companies are required to contribute to an investors' protection fund. The State establishes the fund and erects Chinese walls between brokerage, underwriting, proprietary trading, and securities asset management businesses to ensure robust internal control. Transaction settlement funds of clients of a securities company will be deposited in a separate account opened in the name of the client at a commercial bank to ensure segregation between companies' own funds and client funds. The numerous reforms in the securities law will go a long way to facilitate further development of the capital market in China.

Social Security

China will grow old before it grows rich.²⁸ This presents a unique and singular challenge that no other industrialized countries have faced. Let me give you an illustration of the magnitude of the demographic transformation that is looming ahead. Today, only ten percent of the Chinese population is sixty years of age or over.²⁹ By 2040, the United Nations projects the elderly population will make up twenty percent of the total and will be more than the total current population of France, Germany, Italy, Japan, and the UK combined.³⁰

How China deals with this aging challenge will significantly impact whether it can develop into a stable and prosperous country. What has the Chinese government done?

In 1997, the government issued a policy document laying down the structure of a new national pension system for the urban enterprise sector.³¹ It replaced the old pension system with a new two-tiered basic pension, which consists of a pay-as-you-go benefit component and a personal retirement account component. Although it is intended to cover all urban enterprise workers (including those in the private sector and migrant workers), the implementation is severely resisted by the private sector workers for two key reasons: (1) high contribution rates and (2) lack of confidence in the new scheme, as all contributions are used to pay off liabilities under the pre-reform system. As of 2002, more than nine out of ten private sector workers have no pension coverage.

²⁷ FRESHFIELDS BRUCKHAUS DERINGER, SECURITIES LAWS AMENDED, (Dec. 2005), <http://www.freshfields.com/publications/pdfs/2005/13788.pdf>.

²⁸ Bates Gill, Testimony before the U.S.-China Security and Economic Review Commission, China's Health Care and Pension Challenges, 108th Cong. (Feb. 2-3, 2006), at 5 (statement of Bates Gill, Freeman Chair in China Studies, Center for Strategic and International Studies, Washington, D.C., quoting Richard Jackson and Neil Howe, *The Graying of the Middle Kingdom: The Demographics and Economics of Retirement Policy in China* 3 (Apr. 2004)), http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_02_02wrts/06_02_02_bates.pdf.

²⁹ *Id.* at 6.

³⁰ *Id.*

³¹ Pieter Bottelier, *Where Is Pension Reform Going in China? Issues and Options*, 3 PERSPECTIVES 5 (2002), available at http://www.oycf.org/perspectives/17_063002/Pension_China.htm.

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In the civil service sector, the reform has not progressed nearly as far along as the urban enterprises sector. In rural areas, most of the rural population is not covered by any formal program. So what legal responses are anticipated?

The regulatory framework that governs the investment of the National Social Security Fund (China's public pension reserve) needs to be revised to: (1) strengthen the governance structure and reduce undue government intervention; (2) allow more private asset management to help professionalize the management of the funds; and (3) permit investments overseas to reduce market risks and increase long-term returns. Additionally, a more developed regulatory framework governing private employer-sponsored pension plans is necessary. This would involve close interaction between China's labor department and state tax administration. Finally, clarification of the existing policy is expected so that a clear legal basis for enforcing the collection of social security contributions can be formed.

Land Policy

One of the most frequently discussed topics regarding China is its rising income inequality. The problem is widespread: inequality exists between urban and rural areas, intra-urban and intra-rural areas, and coastal compared to inland provinces. While there are many causes to this phenomenon, I want to focus on just one, China's land policy, which is now high on the government's reform agenda. All of you have read about the violent clashes that occurred in different parts of China over land-taking.³² The ability to formulate a new land policy and effectively implement it will have a significant bearing on China's social stability.

The current system is a bifurcated scheme.³³ Rural land and urban land are subject to different rights regimes. The government acts as the sole mediator of urban-rural interface and has a monopoly on acquiring rural land and transferring it for new urban uses. In other words, rural land must be compulsorily acquired by the government before it can be used for urban purposes. There is no clear delineation of "public purpose."

What problems has this current land system produced? Because compensation for requisitioned land is based on the value of its agricultural use, farmers cannot financially benefit from allowing their land to enter the higher-valued urban market. Landless peasants become extremely vulnerable to poverty. Additionally, the famed Rural Land Contracting Law³⁴ failed to establish an easy-to-use process for farmers to challenge violations of their rights. In fact, a vast majority of the land contracts and certificates that are mandated under the Rural Land Con-

³² XIAOBO ZHANG, INT'L FOOD POLICY RESEARCH INST., DEV. STRATEGY & GOVERNANCE DIV. DISCUSSION PAPER NO. 28, ASYMMETRIC PROPERTY RIGHTS IN CHINA'S ECONOMIC GROWTH 19 (2006), <http://www.ifpri.org/DIVS/DSGD/dp/papers/DSGDP28.pdf>.

³³ Nightly Business Report, Research & Resources for Educators, China: Rural Land Grab (Jan. 11, 2006), http://www.pbs.org/nbr/site/research/educators/060106_23d/.

³⁴ Land Contract Areas Law, (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 29, 2002, effective March 1, 2003), *available at* http://english.gov.cn/2005-10/09/content_179389.htm.

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tracting Law do not even specify the total land area or parcel location of the land contracted to the farmers. Understandably, it would be very difficult for farmers to subsequently challenge any illegal acts of the collectives against their land rights.

What legal responses are emerging? First, reform the Rural Land Contracting Law to formalize land contracting and certificating process and to increase procedure fairness. Second, define “public purposes” and restrict state land taking for public purposes only. Farmers should be allowed to trade their land use rights in the market freely when land conversion is for nonpublic purposes. Third, codify farmer’s land contractual rights as a property right in the new Property Law currently under debate so that the land rights can be enforced and traded under the new law.

Conclusion

Great progress has been made in the legal arena in China. Early reforms have focused on transforming the country from a central planning-based economy to a market-oriented economy. Hence, the legal reform has concentrated on economic laws to facilitate such structural adjustments. Today, new challenges and priorities have emerged, and these are central and crucial to China’s ability to sustain its social-economic development. New issues call for new legal and policy responses. I trust the discussions at this timely Symposium will shed light for all on these exciting and cutting-edge issues.
