

RIDING TWO HORSES: CORPORATIZING ENTERPRISES AND THE EMERGING SECURITIES REGULATORY REGIME IN CHINA

Andrew Xuefeng Qian†

INTRODUCTION

The global wave of privatization started in Britain in the early 1980s, swept across Latin America and other developing countries or regions,¹ and is now landing in Eastern Europe and the former Soviet Union Republics.² China is not immune to the global privatization wave. Because of differing circumstances and context, however, privatization schemes vary from country to country. China's privatization scheme, its securities program in particular, reflects this fact.

In the past, the Chinese government forbade any discussion concerning the establishment of shareholding companies, issuance of stocks to the public, or opening of stock exchanges. Private ownership of stock was thought to be inconsistent with, even heretical to, socialist public ownership,³ the cornerstone of China's political and economic system.

† Expected J.D., Yale Law School, May 1994; M.A., UCLA, 1991; LL.B., Foreign Affairs College, Beijing. I wish to thank Robert Harrison and Timothy Gelatt for helpful comments, M.C. Lee and Adam Ritter for camaraderie-like encouragement, and Olivia Burgos for editorial assistance.

1. See CHRISTOPHER ADAM, *ADJUSTING PRIVATIZATION: CASE STUDIES FROM DEVELOPING COUNTRIES* (1992); see also *PRIVATIZATION IN LESS DEVELOPED COUNTRIES* (Paul Cook & Colin Kirkpatrick eds., 1988).

2. See *PRIVATIZATION PROCESS IN CENTRAL EUROPE* (Roman Frydman et al. eds., 1993).

3. See XIANFA [Constitution] (PRC), trans. available in LEXIS, Intlaw Library, CHINALAW File. Article 6 of the 1982 Constitution of the People's Republic of China provides that "[t]he basis of the socialist economic system of the People's Republic of China is socialist public ownership of the means of production, namely, ownership by the whole people and collective ownership by the working people." Article 7 states that "[t]he state economy is the sector of socialist economy under ownership by the whole people; it is the leading force in the national economy." Article 15 says that "[t]he state practices economic planning on the basis of socialist public ownership." For a discussion of the 1982 Constitution, see William Jones, *The Constitution of the People's Republic of China*, 63 WASH. U. L.Q. 707

Starting in the early 1980s, however, the concept of establishing shareholding companies and issuing stocks to the public was seriously considered and hotly debated as part of a more general discussion regarding the path of economic reform in China. In the last five years, China has taken some significant steps towards establishing a shareholding system, namely, opening stock exchanges, issuing and trading shares, issuing Renminbi-denominated B shares for foreign investors, and listing Chinese companies on foreign stock exchanges.⁴ To regulate China's new, booming securities industry, a securities regulatory regime has emerged which possesses, in the favorite catch phrase of Chinese officials, "distinct Chinese characteristics." The government hopes that China's new securities laws "will absorb foreign countries' experience while taking into account China's situation."⁵

This Comment explores the tension between "China's distinct situation" and the development of its securities program. Will the securities program, which the government now views as essential to improving the economy, erode the very foundation of China's public ownership system? Will the securities laws be able to conform to international standards governing the securities industry, while at the same time, preserve China's particular characteristics? In responding to these questions, this Comment concludes that China's new securities program is, at least in the short run, unlikely to lead to complete privatization in China. Safeguards in the securities laws will guarantee the state's controlling ownership and interest in shareholding enterprises. Nevertheless, the hybrid composition of public, collective, and private ownership in one single shareholding enterprise consti-

(1985). In China, the socialist public ownership consists of all-people's ownership (*quanmin suoyou zhi*) and collective ownership (*jiti suoyou zhi*). The all-people's ownership enterprises are of large and medium size, and are owned by the state; the collective ownership enterprises are of relatively smaller size and owned by the districts, street committees in urban cities or townships in the rural areas. Private ownership (*siyouzhi*) consists of individual enterprises and foreign-owned or foreign-equity enterprises. For a general discussion of law regulating the private enterprises in China, see Alison Conner, *To Get Rich Is Precarious: Regulation of Private Enterprises in the People's Republic of China*, 5 J. CHINESE L. 1 (1991).

4. For Chinese companies listing in Hong Kong, see *China Will List Nine Companies in Hong Kong*, WALL ST. J., Feb. 12, 1993, at A12; see also *Zhongguo Zuce Qiye Gupiao Nianzhong Jiangzai Xianggang Shangshi* [China Registered Enterprises Will Be Listed in Hong Kong in the Mid-Year], RENMIN RIBAO [PEOPLE'S DAILY], Mar. 4, 1993, at 5. In late 1992, Brilliance China Automotive Holdings became the first mainland China company, via Bermuda, to be listed in the New York Stock Exchange. See *Survey of China*, FIN. TIMES, Nov. 18, 1993, at IX.

5. *China's Stock Markets to be More Active*, Xinhua General News Service, Nov. 22, 1992, available in LEXIS, Nexis Library, XINHUA File.

tutes such a significant departure from traditional socialist practice that it represents a "quiet revolution" in Chinese society.

Part I examines the development of China's securities industry and its emerging regulatory regime. Part II explores the debate among Chinese scholars and officials within theoretical circles about whether and how to pursue a securities program under a socialist economic system. Part III discusses the extent to which China's securities laws reflect the consensus reached and address the concerns raised during this debate. Part IV demonstrates the ways China's new securities industry and its regulatory regime will pose a "quiet revolution" for Chinese enterprises (at the micro level) and for China's economic reform and relations with the outside world (at the macro level). Finally, the Conclusion highlights the contradictions that the current securities scheme in China will confront in the foreseeable future.

I. THE AWAKENED MARKET

A. HISTORICAL DEVELOPMENT

Securities markets are not entirely new to China. They have appeared in China during three separate historical periods: (1) the late 19th century (the late Qing Dynasty) to the 1920s;⁶ (2) the 1930s under the Japanese occupation until the end of China's civil war in 1949;⁷ and (3) after the founding of the People's Republic of China ("PRC") in 1949 until the early 1950s.⁸

6. After the Opium War of 1840, foreign investment came into China and foreign companies were established to issue and trade stocks. In 1869, the Shanghai Stock Market [Shanghai Gufen Gongsuo] was first set up by foreign firms in Shanghai, and was restructured in 1905 as the Shanghai Business Market [Shanghai Zongye Gongsuo]. In 1918, Japan set up the Shanghai Securities Branch [Shanghai Quyin Suo] with its headquarter in Osaka, Japan. China issued its first stock in 1872 by the Shanghai General Bureau of Shipbuilding and Commerce. In 1914, the Chinese government enacted "Laws for the Stock Exchange Market." Between 1918 and 1920, China established three large securities markets—Beijing Securities Exchange, Shanghai Securities and Products Exchange, and Shanghai Huashang Securities Exchange. See ZHONGGUO ZHENGQUAN SHOUCHE [CHINA SECURITIES HANDBOOK] 513-14 (Liu Hongru ed., 1992) [hereinafter CHINA SECURITIES HANDBOOK].

7. During the 1930s, securities were traded in Shanghai's concession area until the Pacific War broke out and Japan occupied the concession area. Thus, Shanghai Business Market was closed. After Japan's surrender, the Nationalist government which took over power first prohibited stock trading, and then in 1946 set up the Shanghai Securities Exchange. *Id.* at 514-16.

8. The Tianjin Securities Exchange and Beijing Securities Exchange were established in 1949 and 1950 with the approval from the Financial Committee of the Northern Region Government. The two stock exchanges were closed around 1952 when the Communist Party launched the so-called "three antis" and "five antis" movements against corruption, bureaucracy, and smuggling, which the stock exchanges were accused of spawning. *Id.* at 527-29.

The history of China's securities markets is revealing. Three aspects of this history are particularly noteworthy. First, securities markets have been closely tied to the ups and downs of political development. Imported from the West, China's securities markets have never matured to become independent institutions. On the contrary, they have been vulnerable both to external turmoil (e.g., war, invasion) and to internal turbulence (e.g., civil war, political movements). In order to fully develop, securities markets need the support of a government that is committed to maintaining political stability as well as building a strong economy.

Second, history has demonstrated that securities markets need an independent regulatory regime to prevent it from falling victim to political and social turmoil. After the end of the Japanese occupation of China, the Nationalists abolished the then-existing securities industry as part of a broader anti-Japanese campaign. An independent regulatory regime gives securities markets a measure of autonomy and protection from political storms of the sort that occurred after the Japanese occupation.

Finally, the three different periods of securities development in China have provided Shanghai with experience in dealing with securities markets. Consequently, Shanghai has become the national financial center. It is not surprising, therefore, that Shanghai and Shenzhen, one of China's first Special Economic Zones ("SEZ"s),⁹ were selected as sites for securities markets in the 1990s.

B. RECENT DEVELOPMENTS: PROGRESS AND PROBLEMS

1. *The Bullish Stock Markets*

In December 1978, the Third Plenary Session of the 11th Central Committee of the Communist Party of China ("CPC") simultaneously launched a policy of economic reform and opened China to increased contacts with the outside world.¹⁰ Since then, China has been reforming, *inter alia*, its highly centralized and unitary banking and financial structure. Economic reform created an urgent need to build up China's financial mar-

9. SEZs are the forerunner of China's open-door policy. In response to the reform and open-door policies adopted at the 3rd Plenary Session of the CPC Central Committee, Beijing decided to open up Shenzhen, Zhuhai, Shantou (in Guangdong province), and Xiamen (in Fujian province), in 1980 as the first of China's SEZs, where policies and incentives were more favorable than those in other cities or regions in China.

10. For an overview of China's economic reform and open-door policies, see *THE POLITICAL ECONOMY OF REFORM IN POST-MAO CHINA* (Elizabeth J. Perry & Christine Wong eds., 1985); see also HARRY HARDING, *CHINA'S SECOND REVOLUTION: REFORM AFTER MAO* (1987).

kets. The economy grew rapidly, as did the corresponding capital requirements of the country's various localities and enterprises. However, capital requirements could not be met due to the state's limited financial resources.¹¹ China, thus, began to explore setting up financial markets.¹² Four major markets comprise China's financial market structure: the discount market, the lending market, the foreign currency regulatory market, and the securities market. Of these, the securities market is the biggest in terms of volume and size.¹³

In 1981, the issuance of state treasury bills signaled the take-off of China's securities industry.¹⁴ In August 1986, the People's Bank of China ("PBOC") Shenyang Branch approved a pilot project by the Shenyang Trust and Investment Corporation for various bond transfers, mortgages, and negotiable securities appraisals. This marked the beginning of bond trading in China.¹⁵ In September of the same year, the Shanghai Trust and Investment Corporation's Jin'an Negotiable Securities Department received approval for stock trading.¹⁶ Opening of the Shanghai Securities Exchange ("SSE") on December 19, 1990 and the Shenzhen Securities Market in June 1991 made possible important strides toward standardization and regulation of China's securities industry.

In January 1992, China's senior leader, Deng Xiaoping, called for bold experiments with the securities market.¹⁷ China's

11. There are four primary sources of funds for China's enterprises: (1) fiscal appropriations; (2) funds of enterprises themselves, including retained profits and depreciation expenses; (3) loans from state-run banks, credit cooperatives and trust and investment corporations; and (4) issuing stocks and bonds directly to its employees and to the society. See Gong Zhuming, *Fazhan Zhongguo Zhengquan Gongye De Zhenzheng Yiyi [The True Significance of Developing the Securities Industry in China]*, GAIGE [REFORM], May 20, 1990, at 72, translated in Joint Publications Research Service [JPRS-CAR-90-066], Aug. 29, 1990, at 27, 29.

12. Li Bin, *China's Financial Structural Reform Advances Steadily*, LIAOWANG [OUTLOOK] (overseas ed.), Feb. 25, 1991, at 5, 5-6, translated in Foreign Broadcast Information Service [FBIS] Daily Report—China, Mar. 7, 1991, at 18, 18-20.

13. *Id.*

14. CHINA SECURITIES HANDBOOK, *supra* note 6, at 530.

15. From 1981 (when the first treasury bills were issued) to 1988, bonds (including treasury bills, enterprise bonds, financial bonds) were the main part of the securities industry. Among the bonds, treasury bills had the largest amount of issuance. See XU JIANZHONG, ZHENGQUAN TOUZI: CELUI YU FANGFA [THE TACTICS AND STRATEGIES OF THE SECURITIES INVESTMENT] 250 (1992).

16. Five million yuan of stocks in two collective enterprises, Shanghai Yanzhong Enterprise Ltd. and Shanghai Feile Audio Co. Ltd., were put on the market. For a description of these two companies, see ZHONGGUO GUSHI ZONGLAN [AN OVERVIEW OF CHINA'S STOCK MARKET] 1, 28 (Guan Jinsheng & Wu Zhenbiao eds., 1992).

17. This is the number one news story among the top ten news stories selected by the official Xinhua News Agency for China's securities industry in 1992. See *Top*

securities market has remained quite bullish¹⁸ since, despite ups and downs in the Shanghai and Shenzhen stock exchanges. By the end of 1992, the number of listed enterprises in Shanghai and Shenzhen increased to seventy (up from less than twenty in 1991), eighteen of which issued B shares targeted at overseas investors. The total value of stocks in the two stock exchanges stands at over 100 billion yuan (approximately U.S.\$11.5 billion). As of January 1993, the transaction volume for all of 1992 was expected to reach 100 billion yuan, nearly thirty times the 1991 figure.¹⁹ Average daily transactions on Shanghai's market in the week ending February 12, 1993 reached a record of U.S.\$250 million, nearly as much volume as on a reasonably slow day in the Hong Kong market.²⁰

The securities market has gradually expanded from the central urban cities to the vast rural areas. Farmers, especially those living in the outskirts of the urban cities, are starting to participate in securities activities.²¹ Indeed, China's securities market is reaching not only many parts of China, but also other parts of the world. Aside from issuing B shares in China's two bourses for foreign investors, in 1993 China selected nine state enterprises for listing on the Hong Kong Stock Exchange.²²

Ten News Stories for China's Securities Industry, Xinhua General News Service, Jan. 3, 1993, available in LEXIS, Nexis Library, XINHUA File.

18. One gets a glimpse of the rapid growth of China's stock market by looking at one of its two stock exchanges. When the Shanghai Securities Exchange ("SSE") convened its third annual meeting in late January 1993, the SSE's members had reached 171. This number was up from an initial 17 members in December 1990. Members are spread all over the country except Tibet, Inner Mongolia, Qinghai, and Ningxia. In 1992, the listed securities increased to 73, an 82.5% increase from 1991. The total volume traded reached over RMB 13 billion, a 104.52% increase from 1991, and the total market value exceeded RMB 64 billion, a 535.5% increase from 1991. See *Gongshang Zhengquanye Fazhan Daji* [Big Fortune for the Development of the Securities Industry], RENMIN RIBAO (overseas ed.), Feb. 1, 1993, at 2. The SSE stock index rose from 100 at the time of its opening in December 1990 to 1162.44 on January 27, 1993. See *Shanghai Gupiao Shichang Jin'nian Kaimen Daji* [Good Beginnings for the Shanghai Stock Exchange This Year], RENMIN RIBAO (overseas ed.), Jan. 29, 1993, at 2.

19. *Stock Markets to Extend to Entire Nation in 1993*, Xinhua News Agency, available in FBIS Daily Report—China, Jan. 4, 1993, at 49, 50. At the end of 1992, 100 billion yuan was equivalent to approximately U.S.\$17.5 billion. See *China's Securities Industry Grows*, *infra* note 33. China officially unified its exchange rates and floated the yuan starting January 1, 1994. The government set its first floating rate in decades at 8.7 yuan to the dollar. Just before adoption of the floating rate, the official rate was 5.8 yuan to the dollar. *China Floats Its Currency*, WASH. POST, Jan. 1, 1994, at D5.

20. See Sheryl WuDunn, *Booming China Is Dream Market for West*, N.Y. TIMES, Feb. 15, 1993, at A1, A6.

21. *Securities Market to Develop in Rural Areas in China*, Xinhua News Service, Oct. 3, 1992, available in LEXIS, Nexis Library, XINHUA File.

22. *China Will List Nine Companies in Hong Kong*, *supra* note 4; see also *More Chinese Companies to Test Overseas Stock Markets*, Xinhua News Agency, Oct. 28,

2. *The Emerging Regulatory Regime*

Along with the rapid growth of China's securities program, a regulatory regime has emerged. This regime is tripartite, having an institutional, legal, and administrative framework.

a) Institutions

The two most important institutions in establishing a primary and secondary market in securities are (1) professional securities firms, and (2) stock exchanges. The professional securities firms are divided into national and local companies. At the national level, three securities companies were set up in 1992.²³ At the local (provincial and municipal) level, over fifty regional securities firms and more than two thousand securities offices, some of which were formed in the 1980s when treasury bills and bonds were first issued and traded, are playing a major role in the securities market.²⁴ Over-the-counter trading is conducted at these regional securities firms and offices.

The stock exchanges in Shanghai and Shenzhen started full operation in 1990 and 1991. As nonprofit organizations, they are governed by a board of directors and employ a membership system. Only institutions related to the securities industry can become members.²⁵ The stock exchanges (as well as the securities firms) have gained some independence from both the government departments and the PBOC, the central bank in China. The PBOC used to be the only institution authorized to handle securities transactions. To date, the securities industry employs about 300,000 people, and has quickly become one of the most attractive professions for young people.

b) Promulgation of Rules and Regulations

Because stock markets are still regarded as experimental, regulatory legislation at the national level has generally lagged

1993, available in LEXIS, Nexis Library, XINHUA File (By the end of 1993, six of the nine selected enterprises had been listed on the Hong Kong stock market. The other three are expected to make offerings some time in 1994.).

23. The three national securities companies are Nanfang, Huaxia and Guotai. These companies dominate the securities trade in, respectively, Shenzhen, Beijing and Shanghai. See *Nanfang, Huaxia and Guotai Securities Companies to Open for Business*, JINRONG SHIBAO [FINANCIAL TIMES], Sept. 28, 1992, at 1, translated in *Interview with Chairman of Security Companies*, JPRS-CAR-92-084, Nov. 9, 1992, at 19.

24. *Dalu Gushi De Deyushi* [The Gain & Loss of the Stock Market in the Mainland], LIAOWANG [OUTLOOK] (overseas ed.), Feb. 8, 1993, at 8.

25. See SHANGHAI ZHENGQUAN JIAOYI SUO ZHANGCHENG [Constitution of the Shanghai Securities Exchange], in ZHONGGUO GUSHI ZONGLAN, *supra* note 16, at 410-41; and SHENZHEN ZHENGQUAN JIAOYI SUO ZHANGCHENG [Constitution of the Shenzhen Securities Market], in *id.* at 502-07.

behind regional legislation.²⁶ The State Council and the PBOC, the former watchdog of the securities industry, have issued a number of rules on the issuance and trading of treasury bills and bonds. However, regulations on stocks are far from adequate.²⁷ At the local level, the regulatory regime is more developed. The Shanghai and Shenzhen municipal governments, together with the PBOC local branches, have promulgated a number of rules and regulations governing the issuance and trading of securities, the conduct of securities firms and stock exchanges, the relations between brokers-dealers and investors, and the elimination of insider trading and stock speculation.²⁸ According to one foreign observer, these regulations "are mostly drawn from foreign legislation and are surprisingly sophisticated given the current comparatively moderate level of market activity in Shanghai."²⁹

c) Administration and Supervision

The government has established administrative agencies to police the local stock markets and to oversee the implementation of national and local rules and regulations. The State Council Securities Commission ("SCSC"), the top administrative body, replaced the PBOC³⁰ as national watchdog of the securities industry in August 1992,³¹ and is now headed by Vice Premier Zhu

26. See Andrew X. Qian, *Regulations Needed* [Letter to the Editor], N.Y. TIMES, Mar. 10, 1993, at A26.

27. See GUPIAO FAXING YU JIAOYI GUANLI ZANXING GUIDING [Provisional Regulations Concerning the Administration of Stock Issuing and Trading] (promulgated by the State Council on Apr. 22, 1993); see also GONGKAI FAXING GUPIAO GONGSI XINXI PILU SHISHI XIZE [Detailed Rules of Implementation Regarding Information Disclosure for Companies Issuing Shares to the Public] (promulgated by the Securities Supervision and Control Commission on June 10, 1993) [hereinafter Detailed Rules of Implementation].

28. See *infra* notes 91, 92.

29. Mary Riley, *Seeking a Regulatory Middle Ground*, CHINA BUS. REV., May-June, 1991, at 30.

30. Under the State Council Circular on Further Strengthening Overall Administration of the Securities Market, the PBOC will be responsible for the examination and approval of securities institutions and reporting to the SCSC for the record. Other departments involved are the State Planning Commission (maintain overall balance and draw up a securities plan based on the SCSC opinions), the Ministry of Finance (responsible for the registration of accountants and accountancy firms), and the State Commission for the Reform of the Economic System (responsible for the drafting of laws and regulations for share system experimental enterprises and the coordination of work with respect to experimental enterprises). See GUOWUYUAN GUANYU JINYIBU JIAQIANG ZHENGQUAN SHICHANG QUANMIAN GUANLI DE TONGZHI [State Council Circular on Further Strengthening Overall Administration of the Securities Market] (promulgated Dec. 17, 1992), translated in part in CHINA L. & PRAC., Feb. 25, 1993, at 5, 6 [hereinafter State Council Circular].

31. The SCSC is the organization in charge of the unified control of all securities markets in China. Its main tasks include: (1) responsibility for the drafting of laws and regulations related to securities markets; (2) study and set policies and

Rongji. In addition, the Securities Supervision and Control Commission ("Supervision Commission") works under the SCSC to make day-to-day policies concerning the securities industry.³² The establishment of a national administrative and supervisory body over the securities industry shows that, on the one hand, the government is reluctant to participate directly in the operation of the stock market and is willing to become a "fair judge." On the other hand, the government is also determined to exercise central control over local experimentation to avoid decentralization in the securities industry. This syndrome is vividly described by the Chinese saying, "The sky is high while the emperor is afar."

The securities industry itself set up a nongovernmental regulatory organization, the Securities Association of China ("SAC"), with an initial 186 institutional members and thirty-five individual members. The SAC plays an increasingly important role in enforcing self-regulation of the securities industry, bridging government and industry, training specialists for industry, and maintaining exchanges and contacts with foreign counterparts.³³

Apart from the above three regulatory frameworks, the government strives to improve securities market transparency³⁴ and establish quotation³⁵ and depository systems³⁶ in order to facilitate foreign investment.

guidelines for securities markets; (3) establish plans for the development of securities markets and put forward opinions on the plans; and (4) lead, coordinate, oversee, and investigate the work of localities and relevant departments concerning securities markets. *Id.* China's SCSC is similar to Hong Kong's Securities and Futures Commission (SFC) as a unitary system. See Gareth Hewett, *China Plans SFC-Style Watchdog*, S. CHINA MORNING POST, July 9, 1992, available in LEXIS, Nexis Library, SCHINA File. For the transition of regulatory power from PBOC to SCSC, see Jeffrey Park, *China Central Bank to Shed Stock Regulatory Role*, Reuters BC Cycle, Sept. 22, 1992, available in LEXIS, Nexis Library, REUTER File.

32. The Supervision Commission's main tasks include: (1) under power delegated by the SCSC, to draft regulations on the administration of securities; (2) to implement in accordance with the law, supervision of issue and trade of valuable securities and companies that publicly issue shares; and (3) to implement supervision of domestic companies that issue shares overseas. See *State Council Circular*, supra note 30; see also *State Council Sets Up Two Committees on Securities*, Xinhua General News Service, Oct. 26, 1992, available in LEXIS, Nexis Library, XINHUA File.

33. *China's Securities Industry Grows*, Xinhua General News Service, Dec. 28, 1992, available in LEXIS, Nexis Library, XINHUA File.

34. The official Xinhua News Agency published the first national securities newspaper and weekly magazine that provide the public with information on stock market transactions as well as market analyses and forecasts. See *China Securities News to Greet New Year*, Xinhua News Agency, available in LEXIS, Nexis Library, XINHUA File; see also *Financial Services; Weekly Magazine for Securities Trading*, BBC Summary of World Broadcasts, July 15, 1992, available in LEXIS, Nexis Library, BBCSWB File.

35. An automated quotation system, called the Securities Trading Quotation System ("STAQS") was installed in December 1990. The computer network, head-

3. *The Stock Market's Main Problems*

Although progress has been made, China's securities industry has weak points.³⁷ The main problems are threefold. First, the securities market is too small to supply demand. China's securities market is composed of "two exchanges and one network"—the stock exchanges in Shanghai and Shenzhen, and the national securities trading automated quotation system. The stockholding companies listed in the stock market are limited in numbers. The network is not open to trading by individuals. The serious imbalance between the supply and the demand for stocks is one of the main reasons why stock prices have skyrocketed to an extent that has surprised the world.³⁸ A skyrocketing stock market indicates substantial volatility and the consequent potential for high risk. Because of the short supply and the pent-up demand, the performance of China's stock market is not closely linked to domestic economic changes. It does not quite mirror the operational results of the enterprises.

Second, the securities market is still at an immature stage of development. The securities business has not been sufficiently institutionalized or understood by investors in China. Excessive speculation is rampant. For example, in May 1992, following the lifting of stock price controls three months earlier,³⁹ the turnover

quartered in Beijing, connects with 18 major securities operations and investment and trust corporations in major cities. See *National System Set Up to Help Securities Trading*, Xinhua News Agency, Dec. 5, 1990, available in LEXIS, Nexis Library, XINHUA File.

36. The PBOC plans to set up a Global Depository Route ("GDR"), similar to the American depository system, to accommodate the needs of foreign investment. See *China Exploring New Forms of Depository Receipt*, S. CHINA MORNING POST, July 23, 1992, available in LEXIS, Nexis Library, SCHINA File; see also *China: GDRs May Lure Share Players*, S. CHINA MORNING POST, July 8, 1992, available in LEXIS, Nexis Library, SCHINA File.

37. The factors that cause confusion in stock markets are identified as (1) the laws and regulations and supervisory systems for securities markets are incomplete; (2) there is insufficient experience in the operation of securities markets; (3) investors lack the necessary concept of risk; (4) in some localities there is a tendency to rush the share system reform and development of securities markets; and (5) administration of securities markets is handled by many departments. See State Council Circular, *supra* note 30.

38. Using December 19, 1990 as the base period, the stock index at the Shanghai Securities Exchange was 1232.95 points on May 29, 1992, which represents an average annual growth rate of 493.16%. In Taiwan, the period from 1986 to 1989 saw a speculation frenzy on Taiwan's stock market, which had an average rise of 132.33% per annum. Such a high rate was only 26.83% of Shanghai's annual rate. See Lu Xiaolong, *Growth of China's Securities Market and Future Policy Options*, ZHONGGUO WUJIA [PRICES IN CHINA], Sept. 17, 1992, at 23, translated in JPRS-CAR-92-091, Dec. 3, 1992, at 17, 17-22.

39. See Shao Cunlin, *China's Stock Markets: Report on 1992 Conditions and Future Prospects*, MING-PAO YUE-KAN [MINGPAO MONTHLY] (HK), July, 1992, at 48, translated in JPRS-CAR-92-065, Aug. 25, 1992, at 8, 11-12 (describing the disor-

rate on Shanghai's stock market was forty-nine percent, equivalent to 5.88 times per annum, whereas in the United States and Japan, the rate is usually 0.5 to one turnover per annum.⁴⁰ China's skyrocketing stock prices and the high turnover rate indicate a lack of sophistication among stockholders, who have hardly any concept of the risk involved in stock investment.

Third, the market is not sufficiently transparent. Issuance of stocks is not open enough and unfair trading frequently occurs in the market. Government agencies and high-level officials take advantage of their power to purchase stocks before the public can. Thus, a new unofficial form of stock, the so-called "power shares" (*quangu*), has been created, bringing corruption to the infant securities industry.⁴¹ Fairness, justice, and openness in securities transactions are not embraced nor sufficiently institutionalized.⁴² For example, few of the high-yield stocks are actually issued through open channels. Often there is a big gap between the published quantity of issuance and the actual quantity that people standing in line can purchase. Many stocks have been obtained through "back-door" connections. In August 1992, anger over corruption in the securities markets caused a riot in Shenzhen. Tens of thousands of investors, who had lined up overnight to obtain stock applications, rioted when they discovered the following day that many applications had already been issued to work units that had connections with the issuing company and stock exchange. Furthermore, insider trading within the securities exchange and the professional securities firms is not unusual.⁴³

II. DEBATE WITHIN THEORETICAL CIRCLES

As China has implemented and deepened its economic reform and open-door policies of the late 1970s, theoretical circles

der brought to the Shanghai Securities Exchange by the price decontrol in Feb.-Mar. 1992).

40. Lu Xiaolong, *supra* note 38, at 19.

41. See *Zhendai Zhengshang De "Quangu" Xianxiang* [Syndrome of "Power Shares" Needs To Be Corrected], LIAOWANG (overseas ed.), Feb. 8, 1993, at 9, 9-10.

42. In order to make the market more open and subject to scrutiny, China's accounting method needs to be made consistent with international standards such as the Generally Accepted Accounting Principles ("GAAP"). See Accounting Regulations for Experimental Stock Enterprises (issued by the Ministry of Finance and the State Economic Restructuring Commission on May 23, 1992), translated in JPRS-CAR-92-056, July 29, 1992, at 15. See also Henry Sender, *Pin-Striped Pioneers: For Accountants, China Is the New Frontier*, FAR E. ECON. REV., Nov. 12, 1992, at 59; Yang Aiyi, *Securities Market Standardization Called Imperative*, CHING-CHI TAO-PAO [ECONOMIC REPORTER], Aug. 17, 1992, translated in JPRS-CAR, Oct. 27, 1992, at 24 (discussing the necessity of and the means to standardize China's accounting system to be consistent with established international practices).

43. See *Syndrome of Power Shares Needs To Be Corrected*, *supra* note 41.

in China debate what reform strategies and policy options are desirable, as well as workable. These debates have been and continue to be important to the formulation of government policy, because theoretical circles in China include, *inter alia*, known scholars (economists, political scientists, university professors) and high-level officials. Throughout these debates, the system of enterprise ownership and property rights have been the two most difficult issues to resolve. They are also the two problems that most urgently need to be resolved.⁴⁴

The focus of the debate over ownership and property rights with respect to a shareholding system and stock markets has gradually evolved. In the beginning, the government advocated a contract system (*chengbao zhi*) where, basically, the enterprises would negotiate contracts with the government to arrive at a mutually agreeable amount of annual production to be completed and percentage of profit to be retained by the enterprises. Then, scholars were enthusiastic about a system of property management responsibility (*zichan jingying zeren zhi*) and management targets responsibility (*jingying mubiao zeren zhi*), in which the government would set certain targets for enterprise managers to achieve during their years in office. Eventually, theoretical circles were attracted to the shareholding system (*gufen zhi*). The core issue, throughout the focus shift in the debates, was how to let state-run enterprises make their own business decisions and achieve independence from the government, which had been managing and administering those enterprises through orders and instructions under a highly-centralized, planned economy.

Early in 1979, right after the Third Plenary Session of the CPC Central Committee called for the implementation of Deng Xiaoping's economic reform and open-door policies, only a few scholars challenged or questioned the existing socialist all-people's ownership.⁴⁵ At that time, almost nobody talked about establishing a shareholding system or issuing and trading stocks. Since the mid-1980s, there have been three rounds of debates that focused on developing a shareholding system and stock markets.

A. THE INITIAL DEBATE: 1984-85

China's economic reform began with rural reform in the late 1970s and the early 1980s. Responding to the call of the Third

44. See Chen Shenshen, *Editor's Introduction: On the Question of Ownership and Property Rights in China*, CHINESE ECON. STUD., Fall 1989, at 3, 3-7.

45. See Dong Fureng, *On the Question of the Forms of Socialist Ownership in China*, JINGJI YANJIU [ECONOMIC RESEARCH], No. 1, 1979, at 21, translated in CHINESE ECON. STUD., Fall 1989, at 8.

Plenary Session of the 11th CPC Central Committee for rural reform, peasants were mobilized to raise capital for the initiation of rural enterprises. As the initial reforms progressed, the "share cooperation system" based on a collective economy or joint-household-owned cooperative economy, gradually developed. As the embryo of China's shareholding system, these township and household enterprises were not structured in a standardized shareholding form. Nevertheless, they represented significant departures from the previous monopoly of public ownership. In 1984, the *CPC Central Committee Decision on Reform in the Economic Structure* advocated that China "extensively develop flexible and different types of cooperative ventures and economic integration among the whole-people, collective, and individual economies on a voluntary and mutually beneficial basis."⁴⁶ Guided by this principle, horizontal economic integration increased and joint-stock companies on a cooperative basis emerged.

By the mid-1980s, after rural reform achieved initial success, reformers placed urban reform on their agenda. The plan for urban reform called for adopting both a macro approach (*i.e.*, price reform, banking and finance reform), and a micro approach (*i.e.*, enterprise reform).⁴⁷ At this initial stage, the government took measures to free a large number of state-run enterprises by delegating some power to the enterprises. For example, enterprise managers were granted authority to decide whether to award monthly bonuses to workers who performed well. This scheme of delegating some power to the enterprises was implemented, however, through the contract system between the government and the enterprises.

In Western scholarship, the corporation as an organization is seen as presenting a principal-agency problem concerning the "separation of ownership and control": ownership rights (embodied in stock) are not held by the individuals who manage the

46. See Liu Hongru, *Probe for A Correct Path—Questions on the Experiments in Joint Stock Companies and Stock Market*, ZHONGGUO JINGJI TIZHI GAIGE [CHINA'S ECONOMIC STRUCTURE REFORM], June 23, 1992, at 18, 18-25, translated in JPRS-CAR-92-079, Oct. 21, 1992, at 20.

47. See Hua Sheng et al., *Zhongguo Gaige Shi Nian: Huigu, Fan Si He Qianjing*, [Ten Years in China's Reform: Look Back, Reflection, and Prospect], JINGJI YANJIU, No. 9, 1988, at 13, 25 (summarizing the history of enterprise reform in China). For a discussion of the legal evolution of the Chinese enterprises, especially the Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People (State Enterprise Law, 1988), see James Feinerman, *The Evolving Chinese Enterprise*, 15 SYRACUSE J. INT'L L. & COM. 203 (1989).

corporation.⁴⁸ Ironically, China's enterprises have traditionally avoided this "problem"—there is no separation of ownership and management. The State owns the enterprises and can also appoint or dismiss the managers of the enterprises.⁴⁹ As a result, these managers are not really entrepreneurs, but officials affiliated with government agencies. Thus, they are unlikely to consider the long-term objectives of the enterprises they manage. They are also less likely to take risks. The contract system, though it allows the enterprises to retain some business autonomy, does not aim at achieving the separation of ownership and management. Therefore, independence from the government cannot be obtained by the enterprise through the contract system.

In 1984-85, the World Bank first proposed a shareholding system as a reform strategy for China's enterprises. Under the World Bank proposal, the enterprises' assets were to be divided into shares and owned by several government departments. Breaking up the original single ownership system, this multi-ownership system was expected to (1) improve the efficiency of a public ownership system; (2) specialize government administration through a board of directors; (3) separate the government's social and political goals from those of enterprises alone; (4) build self-management and self-restraint mechanisms within the enterprise; (5) legalize management of the shareholding company; (6) allow worker participation in a company's management; (7) enable enterprises to adopt long-term goals; and (8) raise capital through nongovernment channels.⁵⁰

At the same time that China's scholars and officials were considering the World Bank's proposal, they also began exploring the advantages of a shareholding economy. Some scholars discussed whether a shareholding system could further the objec-

48. See generally ADOLF A. BERLE & GARDNER C. MEANS, *THE MODERN CORPORATION & PRIVATE PROPERTY* (1932); see also FOUNDATION OF CORPORATE LAW 2 (R. Romano ed., 1992).

49. The Government acts as both owner and legislator of the enterprises. As owner, the government is the hierarchical superior of the enterprises. The appropriate state agency can command the manager to achieve certain goals and can replace the manager if those goals are not met. As legislator, the government can pass laws requiring enterprise managers to engage in certain behavior and can then punish the managers if they do not. See Donald Clarke, *Regulation and Its Discontents: Understanding Economic Law in China*, 28 *STANFORD J. INT'L L.* 283, 288-89 (1992).

50. WORLD BANK, *ZHONGGUO CHANGQI FAZHAN DE WENTI YU FANG'AN ZHU BAOGAO* [A MAJOR REPORT ON THE PROBLEMS AND PATTERNS FOR LONG-TERM DEVELOPMENT IN CHINA] (1985); see also *World Bank Experts on China's Enterprise Reforms*, *ZHONGGUO FAZHAN YU GAIGE* [DEVELOPMENT & REFORM IN CHINA], vol. 10, 1987.

tives of enterprise reform⁵¹ and banking and financial reform.⁵² In one of the first articles that advocated the establishment of a shareholding system in China, two young scholars from the Central Committee Party School (the highest-level Communist Party educational institution in China) pointed out three difficulties with China's economic reforms: (1) the improper use and allocation of capital funds, resulting in too much idle capital in society; (2) a contradiction between the government's role as the owner of some of the state-run enterprises and its conduct as the macro manager of all enterprises; and (3) irrational and short-range behavior of the enterprises (*e.g.*, issuing too many bonuses and not devoting sufficient capital to investment).⁵³ As a solution, the two scholars proposed the establishment of a stockholding economy that "has a number of special, even unique, functions."⁵⁴ They maintained that a stockholding economy would provide a means of raising capital, management means, and motivational mechanisms.

Naturally, objections were soon voiced.⁵⁵ Some argued against a stockholding system in China because it might change the nature of the socialist public ownership system. Others said that it would be enormously difficult, if not impossible, to convert the large and medium-sized enterprises into a new form of shareholding system. Also, some preferred to continue and perfect the contract system rather than adopt a risky new shareholding system.⁵⁶ In general, opponents believed that the shareholding system is the product of capitalist social production, that socialist enterprises issuing shares will change the nature of socialism, and that stock speculation will occur in the stock market so that a minority of people may become a new rich class that makes a good living through stock speculation. Therefore,

51. See Shen Mujie, *On Issuance of Stocks and Bonds*, JINGJI YANJIU, No. 1, 1985, at 48.

52. Cai Congzhi, *Wo Guo Jinrong Tizhi Gaige Tan Tao* [*Exploring Reform in Our Banking/Financial System*], JINGJI YANJIU, No. 7, 1985, at 21.

53. See Wu Jiexiang & Jin Lizuo, *Establishing a Shareholding System for Enterprise: A Line of Thought for Further Reform*, CHINESE ECON. STUD., Fall 1989, at 24.

54. *Id.* at 28.

55. See Wang Xiaoqiang & Ji Xiaoming, *Qiye Fei Gufenhua Moshi Sikao* [*Thoughts on Not Establishing a Stockholding System for Enterprises*], ZHONGGUO FAZHAN YU GAIGE [DEVELOPMENT AND REFORM IN CHINA], vol. 1, 1985, at 749, translated in CHINESE ECON. STUD., Fall 1989, at 33; see also Wu Shenli, *Can All Enterprises Issue Stocks?*, JINGJI YANJIU, No. 8, 1985, at 47.

56. See Wang Xiaoqiang, *Chaoyue Siyouzhi De Luoji* [*Transcending the Logic of Private Ownership*], ZHONGGUO FAZHAN YU GAIGE, vol. 4, 1985, at 27, translated in CHINESE ECON. STUD., Fall 1989, at 43.

“adopting the shareholding system would be a setback for socialism.”⁵⁷

When debate over the shareholding system first arose in 1984-85, no consensus was achieved within theoretical circles. Soon the heat of the debate subsided. Scholars looked elsewhere for reform strategies and policy choices. In 1986, there were proposals calling for small and medium-sized state-run enterprises to adopt a policy of “contracting, leasing and selling” and for all large state-run enterprises to implement a system of property-management responsibility.⁵⁸ In October 1987, however, Zhao Ziyang, then the CPC’s General Secretary, in a report to the 13th Party Congress, affirmed the securities program in principle and approved experimentation with the securities program:

Various forms of a system of shares in enterprises have appeared during the reform. These include purchase of shares by the state, collective purchase by departments, localities and other enterprises and purchase by individuals. This system is one means of raising money for socialist enterprises and can be further implemented on a trial basis.⁵⁹

Debate continued within theoretical circles over the desirability and necessity of focusing enterprise reform on the development of a shareholding system with stock markets. As a result, the securities program moved forward slowly and strictly on a trial basis. The practice may be compared to “crossing the river while touching the stones in the river bank”—a little courage followed by a great deal of caution.

B. THE CONTINUING DEBATE: 1987-89

In 1987-88, the theoretical circles revisited the debate over establishing a shareholding system. At that time, China faced hyperinflation and corruption, which were regarded as the by-products of the existing system. Many state-owned enterprises were performing poorly.⁶⁰ The second round of debate was distinctive in two respects. First, the concept of property rights was separated from the concept of ownership. Many scholars realized that in China, the simple dichotomy of “public” versus “pri-

57. Gu Shutang, *Dui Gufenzhi De Pingjia* [Comments on the Shareholding System], JINGJIXUE WENZHAI [SELECTED ARTICLES IN ECONOMICS], vol. 7, 1987, at 4.

58. See Chen Shenshen, *supra* note 44, at 5.

59. See Zhao Ziyang, *Advance Along the Road of Socialism with Chinese Characteristics—Report Delivered at the 13th National Congress of the Communist Party of China on October 25, 1987* (translation on file with the UCLA Pacific Basin Law Journal).

60. According to a survey of 13 cities in China concerning the drive to revitalize the large and medium-sized enterprises, 20-30% of enterprises achieved good results; 50-60% of enterprises showed some but no obvious improvement; and the other 20% of enterprises experienced no change. See Gu Shutang, *supra* note 57.

vate" ownership could no longer encompass the complicated property relations between different levels of government and among all kinds of public organizations and institutions.⁶¹ Thus, the separation of the concept of property rights from the traditional concept of ownership system paved the way for further discussion of a shareholding system and stock markets.⁶²

Second, some young scholars proposed the implementation of a comprehensive private ownership system. The issuance of stocks and trading in a stock market were major parts of the privatization scheme. In February 1989, *Shijie Jingji Daobao* ("The World Economic Herald"), regarded as China's most liberal newspaper in the 1980s,⁶³ published a letter from several Chinese Ph.D. students from Stanford University. The students argued that so long as the traditional system of public ownership existed, the "property relationships are still blurred and murky."⁶⁴ With the government firmly holding the enterprises in their hands, the enterprises were unable to free themselves from their sense of dependence on all levels of the government.⁶⁵

While the students' diagnosis of the problems of China's economic reform did not differ much from other scholars, their prescription was very "liberal": they proposed to completely reform the microeconomic foundations of China by converting state-owned property to an ownership by private individuals. Obviously, the individualization of state-owned property was tantamount to the privatization of state-owned property.

61. The state (central government) does not own directly all "state-owned" enterprises, which may be owned by government units at different levels (provincial, municipal, or county). Thus, "ownership" means a characterization set of rights relating to the enterprise, the most important of which are the right to the physical use of the output and the right to the financial cash flow produced by the enterprises. See DAVID GRANICK, *CHINESE STATE ENTERPRISES: A REGIONAL ANALYSIS* 32 (1990). To the Chinese legal scholars, ownership consists of four separate rights: the right to occupy, the right to use, the right to profit and the right of final disposition. See General Principles of Civil Law art. 71 (PRC), translated in *General Principles of Civil Law of the People's Republic of China*, (Whitmore Gray & Henry Ruiheng Zheng, trans.), L. & CONTEMP. PROBS., Spring 1989, at 27, 41. The government's ownership derives from the initial investment made by the government. See Clarke, *supra* note 49, at 290-94.

62. See Chen Shenshen, *Clarifying Property Rights Relationships Is a Necessary Premise*, CHINESE ECON. STUD., Fall 1989, at 57.

63. The *Shijie Jingji Daobao* was closed down in April 1989 by the Shanghai Communist Party Committee on the charge of bourgeois liberalization.

64. Li Yunqi et al., *Guoyou Caichan Gerenhua: Zhongguo Jingji Gaige De Qushi Yu Xuanze—Gei Zhongguo Lingdaoren De Jianyishu* [The Individualization of Ownership of State-Owned Property: Trends and Choices for Chinese Economic Reform—Suggestions for China's Leaders], SHIJIE JINGJI DAobao, Feb. 27, 1989, at 15, translated in CHINESE ECON. STUD., Fall 1989, at 83.

65. *Id.*

The students outlined the method to achieve the goal of nationwide individualization of state property. First estimate the value of all state-owned property in a given area, and then divide the value among individuals within that region in the form of stocks and shares.⁶⁶ Next, a stock market would be formed for stock trading. Boards of trustees or directors would also be organized. "Ultimately, a new property rights system will be established."⁶⁷

This liberal idea of individualization of state assets was echoed at home by three young economists from the Chinese Academy of Social Sciences in Beijing.⁶⁸ They also thought that China must abandon state ownership and distribute state-owned property to the people in the form of stocks and bonds. Similarly, they proposed that nation-wide stock exchanges based on the U.S. model be established.⁶⁹ During this second round of discussion, despite some opposition to the shareholding system,⁷⁰ an increasing number of scholars realized the necessity as well as the benefits of developing a new shareholding system.

As enthusiasm was rising and consensus was gathering in theoretical circles, two events occurred that temporarily changed the course of the debate. First, in 1988 the government introduced an economic austerity program. The program, which was backed by conservatives, sought to combat high inflation and worsening corruption by instituting a policy of tight credit and tight central control of the economy. The austerity program effectively halted the securities experiment. Second, the Tiananmen Square incident on June 4, 1989 and the subsequent fall of Zhao Ziyang and other reformers put in question the continuing development of China's securities program. However, this political instability did not remove the necessity of developing a shareholding system. Quite to the contrary, many state-owned enterprises were economically strapped and relying heavily upon government subsidies. Further, the serious economic situation that resulted from halting economic reform made it

66. *Id.*

67. *Id.*

68. See *Stock Back in Chinese Vocabulary*, CHI. TRIB., Jan. 29, 1989, at A11.

69. *Id.*

70. See Xue Muqiao, *Bu Neng Ba Suoyouzhi Gaige Zuo Wei Shenhua Qiye Tizhi Gaige De Hexin* [We Cannot Put Ownership System Reform as the Core of the Deepening of the Enterprise Reform], JINGJI RIBAO [ECONOMIC DAILY], June 4, 1987; see also Guang Menjue, *The Shareholding System Is a Denial of All-People's Ownership System in the State-Owned Enterprises*, JINGJI SHEHUI TIZHI BILIAO [COMPARISON OF ECONOMIC AND SOCIAL SYSTEMS], vol. 3, 1987; Gao Di, *Chengbao Zhi Yu Gufen Zhi* [The Responsibility System and the Shareholding System], RENMIN RIBAO, Jan. 27, 1989.

more urgent than ever before to develop a shareholding system and related stock markets.

C. THE RENEWED DEBATE: 1989-92

By 1989, the low productivity and money losing operations of state-owned enterprises were widely understood to be the result, at least in part, of their urgent need for more capital. Borrowing money from other enterprises caused the enormous so-called "triangular debt" problem; enterprises owed money to each other, and the setoffs in mutual and multilateral indebtedness grew unbearably complicated. Meanwhile, obtaining subsidies from the central government was no solution either, because it put too heavy a burden on the government's budget. One way to get out of this quagmire was to reform the mechanisms of operation and management in the enterprises.

At the same time that state-run enterprises were experiencing a bottleneck problem in the short supply of capital, there was a significant increase in the purchasing power of the Chinese people by 1989. Bank deposits made by urban and rural residents stood at 703.4 billion yuan by the end of 1990.⁷¹ The huge amount of funds, likened to a "tiger in a cage," caught the attention and interest of economists and entrepreneurs.

The renewed debate on the shareholding system and stocks took place under these circumstances. This time, the theorists bore a growing sense of urgency, wishing to implement the securities program on a wider scale; but the debate occurred not long after the Tiananmen Square incident, when the overall political atmosphere was still rather tense. Not surprisingly, therefore, the renewed debate over the securities program engendered some sharp exchanges. In general, theorists argued from one of three viewpoints: the conservative, the pragmatic, and the policy-oriented.

1. *The Conservative Viewpoint*

The conservative group stressed the politically sensitive issue of the nature of a shareholding system and stocks. The far-leftist denounced, as a clear reflection of bourgeois liberalization, the view that economic phenomena such as a shareholding system and stock markets were politically neutral and should not be characterized as socialist or capitalist. They attacked the proposal of individualizing state assets and converting them eventually

71. See Wang Pingxing, *A Glimpse of China's Securities Market*, Xinhua News Service, Feb. 11, 1991, available in FBIS Daily Report—China, Feb. 11, 1991, at 49, 50.

to a system of private ownership.⁷² This far-left group, though small in number, occupied important positions within the party propaganda apparatus, including the party propaganda department, the Ministry of Culture, and the major newspapers in China.

Some traditional Marxist economists also expressed concern over the ideological implications of a shareholding system and stock markets. As one of China's senior economists observed,

I would like to take up again here the abovementioned notion of stock markets of a socialist nature. In other words, I am leaving the nature of stock markets unsettled here. I do not think that things in socialist societies are equivalent to those of a socialist nature Stock markets in socialist societies are equivalent to neither stock markets of a socialist nature, nor stock markets that are part of a socialist economic system.⁷³

2. *The Pragmatic Viewpoint*

Pragmatism was the trademark of the second group of scholars. They stressed the benefits of, and the urgent need for, establishing a shareholding system and stock markets without getting bogged down in an endless debate over the ideological aspects of the shareholding system. Coming mainly from universities and research institutes, they launched a counterattack against the conservatives. One scholar distinguished the forms of realization of socialist public ownership from the socialist public ownership system itself.⁷⁴ He argued that a shareholding system should replace the contract system as a major form of socialist ownership, since the shareholding system would not necessarily threaten so-

72. See Wang Yifu, *Jingji Lingyu Zichan Jieji Ziyouhua De 12 Ge Biaoxian* [Twelve Reflections of the Bourgeois Liberalization in the Economic Field], LILUN XINXI BAO [THEORETICAL INFORMATION DAILY], Aug. 7, 1989, reprinted in JINGJIXUE WENZHAI, No. 12, 1989, at 9; see also Wu Shuqing, *Siyouhua Gucui zhe De Lilun He Celui* [Theory and Strategy of the Privatization Advocates], JINGJI CANKAO [ECONOMIC REFERENCE], Aug. 7, 1989, reprinted in JINGJIXUE WENZHAI, No. 10, 1989, at 7.

73. See Yu Guangyuan, *Reflections on China's Newly Emerging Stock Markets*, CAIMAO JINGJI [FINANCING AND ECONOMICS], Feb. 11, 1991, at 14, 14-18, translated in JPRS-CAR-91-032, June 13, 1991, at 39, 40-41.

74. The author identified five areas of significance in the discussion of ownership issues: (1) some people confuse the essence of public ownership with the forms of realization of public ownership, thinking that changes in the forms of realization of public ownership will invariably lead to changes in the essence of public ownership; (2) some people see the forms of realization of public ownership as a frozen concept; (3) some people see the forms of realization of public ownership as unimodal; (4) some people see particular forms of realization of public ownership as absolute; and (5) there is a lack of in-depth study and discussion on the distinctions and links between the present and future forms of realization. See Xiao Zuoji, *Shixin Shehui Zhuyi Gongyouzhi De Xinshi* [On the Forms of Realizing Socialist Public Ownership], JINGJI YANJIU, No. 2, 1992, at 38.

cialism itself, being instead a product of socialization and commercialization of the means of production:⁷⁵

The shareholding system has emerged under the capitalist system but it is not the exclusive right of capitalism. Rather, it is the product of the socialization and commercialization of production. It may exist under the capitalist system but it can also exist under the socialist system and serve socialism.⁷⁶

Another pragmatic scholar displayed his discontent over the fact that the debate overemphasized the ideological aspect. "Setting up a socialist capital stock funding mechanism in our country is neither theoretical reasoning nor a subjective prediction. It is an urgent objective demand for development of the economy as well as the practices of reform and development in our country."⁷⁷ He suggested further that the enterprise shareholding system, though originating in capitalism and based on private ownership, is able to coexist with more than one particular social system.⁷⁸

Li Yining, a well-known economics professor at Beijing University, wrote that the nature of a shareholding system depends on the nature of its investors.⁷⁹ Domestic investors would fall under four categories: (A) the state; (B) the enterprises; (C) individuals in society; and (D) the employees of the enterprises. The first two categories involve a public ownership nature, and the fourth entails a measure of collective economic cooperation. Only the third category—individual investors—involves private ownership. Thus, the securities program would not endanger the dominant elements of public ownership in the economy.⁸⁰

In another article, Professor Li examined the immediate and long-term possibilities for development of securities markets in China. He argued, that in the short run, issuing debt and stocks through the securities market would help alleviate the fiscal difficulties and capital shortages of the enterprises. This could also

75. *Id.* at 41.

76. *Id.*

77. Qi Liang, *Jianli Shehui Zhuyi Qiye Zhijin Zhouzhuang Jizhi [Establishing Socialist Enterprise Capital Stock Funding Mechanism]*, JINGJI GUANLI [ECONOMIC MANAGEMENT], Mar. 5, 1992, at 27, translated in JPRS-CAR-92-062, Aug. 14, 1992, at 6, 6-11.

78. *Id.*

79. Li Yining, *The Nature of the Shareholding System Depends on the Investors*, GUANLI SHIJI [WORLD OF MANAGEMENT], Jan. 24, 1992, at 18, 18-20, translated in JPRS-CAR-92-027, May 8, 1992, at 5, 5-7.

80. Professor Li divides the enterprises into 15 types out of the four types of investors. Among the 15 types, seven are public economic types, A (state owned shares), B (enterprise corporate shares), D (employee shares), AB, AD, ABD, and BD. C (social individual shares) is of private economic type. The remaining eight can be primarily of public economic type, or be of a mixed economic nature. They are: AC, ABC, ACD, BC, BCD, CD, and ABCD. *Id.* at 6.

benefit the banks by alleviating pressure on them to supply capital. For the long-term, securities markets would promote a free, rational, and optimal flow of resources to the most efficient industries, regions, and enterprises, thus achieving the greater nationwide economic efficiency being pursued.⁸¹

3. *The Policy-Oriented Viewpoint*

The third viewpoint was shared by a group of reform-minded senior officials and scholars. They took a more policy-oriented approach, pragmatic and less ideological, yet cautious and less risky. As a group, they emphasized the practical benefits of establishing a new securities system. They did not regard a new securities system as a complete transformation, and they believed it could be implemented step-by-step under central leadership. Jing Shuping, a prominent quasi-government official,⁸² saw three advantages in instituting a shareholding system: "First, it can turn some of the consumption fund into production fund and promote the development of production. . . . Second, it is a new way to absorb foreign capital. . . . Third, it helps enterprises to restrain themselves and makes them improve efficiency and develop healthily."⁸³

Liu Hongru, Vice Minister of the State Commission for Restructuring the Economic System, which is responsible for charting a course for healthy development of the securities industry, endorsed the securities industry but repudiated the liberal concept of "privatization" (*siyouhua*). He cautioned people that "the mistake. . . is in the 'actual pursuit of privatization,' not the system which was used as the front. What we resolutely oppose is privatization. But we do not because of that oppose a stockholding system."⁸⁴ That is to say, people should not give up eating for fear of choking.

Through this renewed and heated debate, some consensus was achieved within theoretical circles regarding a desirable expansion trial for the securities program. Most scholars agreed on three points. First, a shareholding system and stock markets were urgently needed. Second, such institutions would not nec-

81. Hu Wannian, *Li Yining Views Securities Market*, JINRONG SHIBAO, Apr. 4, 1991, at 1, translated in JPRS-CAR-91-036, June 24, 1991, at 49.

82. Mr. Jing is the vice chairman of the Economy Commission of the Chinese People's Political Consultative Conference ("CPPAC"), a permanent director of the China International Trust and Investment Corporation ("CITIC"), vice chairman of the All-China Federation of Industry and Commerce, and also the new chairman of the board of China's Stock Exchange Research and Planning Joint Office. In 1985 he was one of the first persons who suggested that China try a shareholding system.

83. *Interview Report*, Zhongguo Xinwen She [China News Service], Dec. 21, 1990, translated in FBIS Daily Report—China, Dec. 27, 1990, at 52.

84. See Liu Hongru, *supra* note 46.

essarily lead to privatization, nor would they alter the more dominant elements of public ownership in China's economy.⁸⁵ Third, a securities program should be introduced incrementally under the central government's leadership, but municipalities should have sufficient autonomy and flexibility to experiment with the shareholding system and stock markets.

The debate over the shareholding system and stock markets significantly influenced government decision-makers. Increasingly, they turned to the theoretical circles and think tanks for advice during the reform years. After the fall of Zhao Ziyang, the party General Secretary and supreme arbiter of support for a securities program in the 1980s, top government officials at first were not enthusiastic about vigorous pursuit of a securities program. The *CPC Central Committee Proposals on Formulating the 10-Year Program on National Economic and Social Development and Eighth Five-Year Plan (1991-1995)*, which was drafted under Premier Li Peng's auspices in December 1990, suggested only "gradually expanding bond and stock issues, vigorously strengthening management. . . and [b]uilding and perfecting securities exchanges in metropolitan areas having the right conditions."⁸⁶ However, the trip by China's senior leader Deng Xiaoping to southern China at the beginning of 1992, which topped the ten most important events in China's securities industry in 1992,⁸⁷ injected new vitality into the growth and development of China's stock market. During his tour, Deng commented, "Securities and stocks, whether these things are useful or harmful, whether they can only be used by capitalism or can also be used by socialism, we need to wait and see. But we must resolutely try them."⁸⁸

85. See Li Yining, *supra* note 79.

86. See Willy Lam, *Li Peng Backs Stock Exchange Development*, S. CHINA MORNING POST, May 7, 1991, at 12. Li Peng originally held a conservative viewpoint towards stock markets. See, e.g., Li Peng, *Continue to Work For Stable Economic and Social Development in China—Report on the Work of the Government*, BEIJING REV., Apr. 16-22, 1990, at I (centrefold); see also Pitman B. Potter, *The Legal Framework for Securities Market in China: The Challenge of Monitoring State Control and Inducing Investor Confidence*, 7 CHINA L. REP. 61, 77-78 (1992) (Discussing Li Peng's speech to the Central Party School in May 1991: "Li Peng indicated that foreign investment in Chinese securities markets might be permitted, but only on an experimental basis. . . . [I]n his June speech to the Fourth Session of the 7th National People's Congress, Li omitted mention of securities markets in his discussion of the need to utilize foreign funds better. These remarks were consistent with Li's earlier expressions of caution concerning the original establishment of securities exchanges in China.").

87. See *Top Ten News Stories*, *supra* note 17.

88. See *Deng Xiaoping's Tour Gives Rise to Stock Heat*, SHENZHOU XUEREN [CHINA'S SCHOLARS ABROAD], vol. 2, 1993, at 23.

In China, law is preceded by policy, and policy is often shaped by the debate within theoretical circles.⁸⁹ Once a policy has been formulated that gives a green light to a practice, what follows next is an enactment and promulgation of laws, rules, and regulations. The securities program is no exception.

III. A FRAMEWORK OF THE SECURITIES REGULATORY REGIME

The legislation of China's securities laws has two unique features. First, there are almost no securities laws at the national level.⁹⁰ As a result rules and regulations are not systematic. Only in Shanghai⁹¹ and Shenzhen,⁹² where stock exchanges are in operation, are there rules and regulations. These local rules are quite detailed and specific with regard to issuing and trading

89. The most well-known example in China was the debate on whether practice is the only criteria in testing truth in the late 1970s and early 1980s. The result of the debate laid the theoretical foundation for Deng and other reformers to remove the leftist "Two Whatever" faction and initiate reform and an open-door policy.

90. The legislation of economic laws in China follows a philosophy set by Deng Xiaoping. He said early in 1978 that since there was a great amount of legislative work to be done, in the beginning, laws could be general and sketchy, and later be perfected. Some regulations can be made by the localities, and would become national laws after their trial and summary. He believed China should amend each law provision as it was ready for amendment; China should not wait for "the whole set of equipment." Qiao Shi, the newly elected NPC Chairman, said recently that when the national laws were still imperfect, the localities could try to make some local regulations. See *Guangdong Can Be a Trial Land for National Legislation*, RENMIN RIBAO (overseas ed.), Apr. 16, 1993, at 1.

91. See Shanghai Securities Transaction Regulations (Nov. 27, 1990), translated in FBIS Daily Report—China, Dec. 20, 1990, at 46 [hereinafter SSTR]; see also SHANGHAI SHI GUFEN YOU XIAN GONGSI ZANXING GUIDING [Shanghai Tentative Provisions on Shareholding Limited Liability Company] (May 18, 1992), in ZHONGGUO GUSHI ZONGLAN, *supra* note 16, at 364-91; and Shanghai Securities Market Constitution, *supra* note 25. For a comparison of the SSTR with previous regulations, see Potter, *supra* note 86, at 73 ("[W]hile the 1990 Shanghai securities regulations were intended to liberalize securities market activity, they are sharply constrained by prior enactments that limited the possibilities of meaningful liberalization. . . . [T]he new regulations retain the disparate treatment given stock and bond issues, and the insistence that transactions in securities be limited to exchanges controlled by PBOC/Shanghai.").

92. See SHENZHEN SHI GUPIAO FAXING YU JIAOYI GUANLI ZANXING BANFA [Tentative Procedures for Stock Issuance and Trading Administration in Shenzhen] (effective June 15, 1991), in ZHONGGUO GUSHI ZONGLAN, *supra* note 16, at 514; see also SHENZHEN SHI ZHENGQUAN JIGOU GUANLI ZANXING GUIDING [Shenzhen Municipality Administration of Securities Organizations Tentative Provisions] (effective June 25, 1991), in *id.* at 487-501; SHENZHEN SHI GUFEN YOU XIAN GONGSI ZANXING GUIDING [Shenzhen Tentative Provisions on Shareholding Limited Liability Company] (promulgated Feb. 19, 1992), in *id.* at 428-67; and SHENZHEN SHI SHANG SHI GONGSI JIANGUAN ZANXING BANFA [Shenzhen Tentative Provisions on Supervising the Limited Liability Company] (promulgated Apr. 4, 1992), in *id.* at 468-86. For a discussion of the legislation history of the Shenzhen regulations, see Potter, *supra* note 86, at 74-76.

of stocks, regulating broker-dealers, and operating the stock exchanges themselves. These local rules and regulations have become the backbone of China's new securities law regime.⁹³ Therefore, the following discussion of China's securities law regime will focus mainly on the laws promulgated in Shanghai and Shenzhen.

A. A LEGAL FRAMEWORK IN SHANGHAI AND SHENZHEN

1. *Issuing Stock*

Companies newly established in a shareholding form or restructured from a previously state-owned form may apply for stock issuance in a stock exchange. The Shanghai rules provide that the issuer must first apply to the securities administrative authority, namely the PBOC Shanghai Branch.⁹⁴ The application materials must include an application form, a company charter, a prospectus, and the contract with the underwriter. If capital is raised for investment in property, plant, and equipment, the application materials must also contain approval documents from a high-level authority, such as the PBOC.⁹⁵

A newly established stockholding company must also provide a letter approving its establishment or restructuring as a stockholding company, a certificate from the asset management agency that the newly established or restructured shareholding company will purchase no less than thirty percent of the shares it offers, and a letter of asset assessment confirmation for the state-owned company or from an accounting firm for other types of companies, including collective enterprises and Sino-Foreign joint ventures.⁹⁶ Other provisions govern the prospectus, the contract with the underwriter(s), notification, methods of underwriting, and selling.⁹⁷

Compared with Shanghai's rules governing the issuance of stocks, Shenzhen's rules are more stringent. Before being permitted to issue stocks, a company's production, management, and financing practices must meet with government approval. A company must have net assets of no less than ten million yuan, of

93. For comparison of the Shanghai and Shenzhen regulations, see Riley, *supra* note 29, at 30; see also CHEN QUANGUI, *ZHONGGUO GUPIAO JIQIAO* [TECHNIQUES IN CHINA STOCK TRADING] 279-85 (1992).

94. SSTR, *supra* note 91, art. 8. In general, the Shanghai regulations reveal a preoccupation on the part of PBOC and its Shanghai Branch with maintaining its regulatory authority, while in Shenzhen, efforts were made to insulate the stock exchange from undue intervention by PBOC and its Shenzhen branch. Potter, *supra* note 86, at 93-94.

95. SSTR, *supra* note 91, art. 9.

96. *Id.* art. 10.

97. *Id.* arts. 16, 18-19, & 22.

which not less than twenty-five percent must be tangible assets. The issuing company must itself purchase no less than thirty-five percent of total shares offered. The stockholders may not number fewer than 800 people.⁹⁸

Like their counterparts in Shanghai, stock companies in Shenzhen need to submit various documents along with their applications.⁹⁹ Underwriter(s) must also follow strict rules.¹⁰⁰ Article 29 of the Tentative Procedures for Stock Issuance and Trading Administration in Shenzhen prohibits an individual shareholder from purchasing more than 50,000 yuan worth of shares in total. Furthermore, certain groups may not purchase or trade stocks, such as cadres working in the party and government agencies, soldiers in military service, and personnel working in departments related to the securities markets.

Characteristics unique to China's securities industry are reflected in special provisions of the Shanghai and Shenzhen regimes regarding the composition of shares. Shares are divided into three kinds: state shares, legal person shares, and individual shares.¹⁰¹ State shares bring state-owned assets into the shareholding company, and usually constitute over fifty percent of the total shares issued. Legal persons shares are those owned by a company. Companies may purchase their own shares or those of another shareholding company. Individual shares are held by the employees of a company as well as other members of the general public. These three kinds of shares are issued roughly in a 5:3:2 ratio in accordance with securities regulations. State shares and legal persons shares are of public ownership nature—a unique feature of the Chinese shareholding system that is fully consistent with China's public ownership system. So far, only individual shares can be traded in the stock market, which account for a small fraction of the total shares. Furthermore, individual shareholders are restricted in the number of shares they can purchase.¹⁰²

The latest draft of the first national securities law would implement a policy of openness and substance administration (*gongkai yu shizhi guanli*) with respect to stock issuance. That means that a stock issuing company must not only fully disclose

98. Tentative Procedures for Stock Issuance and Trading Administration in Shenzhen, *supra* note 92, arts. 15-16.

99. *Id.* art. 17.

100. *Id.* arts. 22-27.

101. See Shenzhen Tentative Provisions on Shareholding Limited Liability Company, *supra* note 92, arts. 35-36.

102. One individual shareholder can not purchase shares equaling over 0.5% of the total shares issued. Shanghai Tentative Provisions on Shareholding Limited Liability Company, *supra* note 91, art. 58.

information investors need to make informed decisions, but also meet several additional issuing requirements. Furthermore, a stock issuing company must obtain the approval (*shenpi*) as well as authorization (*hezhun*) from securities administrative authorities. Chinese officials predict that this extensive regulatory regime may be relaxed as the nation's securities markets mature.¹⁰³

2. Stock Trading

The Shanghai provisions require a stock issuer to apply for the right to have its stock traded.¹⁰⁴ Upon approval, an issuer must then disclose certain information, including the company's reports and its financial statement. The latter, which must be certified by the public accounting office, must show that the company has been profitable for at least two years. A company whose stocks are traded over-the-counter must also disclose its mid-year and annual financial statements. Any new developments that might affect the company must be reported to the securities authorities within fifteen days.¹⁰⁵

Shanghai's rules enumerate certain forms of trading that are prohibited. Article 27 bars any securities trading outside the securities market; Article 39 prohibits insider trading, manufacturing or spreading misleading and fraudulent information, and stock speculation. Article 40 forbids certain groups from engaging in stock trading, including government staff directly related to the stock issuer; personnel of the securities administrative authorities, of the stock exchange, and of securities business organizations directly involved with issuance and trading of stocks; and other insiders.

Shenzhen's rules for stock trading are more specific regarding the issuer. In order to be listed on a stock exchange, a company must satisfy capital and financial performance requirements over and beyond the basic requirements for stock issuance mentioned above. For example, according to Article 37 of the Tentative Procedures for Stock Issuance and Trading in Shenzhen, the company must have issued no less than twenty million yuan in ordinary shares. Its return on capital over the prior two years must be no less than 8%, and no less than 10% in the last year. The company must have at least one thousand registered shareholders, and at least 25% of them must have holdings of no more than 0.5% of the shares of the company.

103. See Fu Wenjie, *NPC Standing Committee Is Speeding Up Drafting the Securities Law*, LIAOWANG (overseas ed.), Feb. 22, 1993, at 3.

104. See SSTR, *supra* note 91, art. 32.

105. *Id.* arts 36-37.

Despite Shanghai's and Shenzhen's local regulation of stock issuance and trading, the promulgation of regulations at the national level (*i.e.*, the Provisional Regulations Concerning the Administration of Stock Issuance and Trading and Detailed Rules of Implementation Regarding Disclosure of Information for Companies Issuing Shares to the Public) has made significant headway toward unifying such regulation. For example, according to the Detailed Rules of Implementation, no matter where a company issues and trades its shares, it must satisfy specific requirements set forth therein for the disclosure of certain information, including a prospectus, registration statements, regular reports, and temporary reports.¹⁰⁶

3. *Securities Firms and Stock Exchanges*

In Shanghai, securities firms or other financial institutions that intend to conduct securities transactions must apply for approval. Their scope of business is restricted and certain activities are forbidden. There is a reporting system for securities firms.¹⁰⁷ The rules for establishing a stock exchange are even stricter.¹⁰⁸ Needless to say, approval from the top level of the government, namely, the State Council, is required. The Shanghai Securities Exchange is a non-profit legal entity that operates on a membership system. Members include securities firms, big banks, and trust and investment companies.

In Shenzhen as in Shanghai, securities firms need government approval. The scope of their business and their trading procedures are regulated. The Shenzhen Securities Exchange Constitution provides that the exchange is a non-profit legal entity with a registered capital of ten million yuan. It also defines the scope of transactions permitted on the exchange, the conditions for acquiring membership, the rights and obligations of members, and the internal governing structure (*i.e.*, the Members' Council, the Board of Directors, and the Supervisory Council).

4. *B Shares for Foreign Investors*

In order to attract foreign capital and open up its stock markets to the outside world, China authorizes shareholding companies to issue two different kinds of stocks: A shares and B shares. A shares are sold and traded only internally (*i.e.*, by Chinese citizens). B shares, on the other hand, (1) have a face value denominated in Renminbi; (2) are traded in U.S. dollars in both

106. See Detailed Rules of Implementation, *supra* note 27, art. 4.

107. SSTR, *supra* note 91, arts. 41-48, 51-54.

108. *Id.* art. 55.

Shanghai and Shenzhen markets;¹⁰⁹ (3) are sold to foreign residents and foreign investment corporations both inside and outside China;¹¹⁰ and (4) otherwise enjoy the same rights as A shares.

Originally, China considered two ways to import foreign capital through the securities market. The first was to issue B shares, as Thailand had done. The other was to follow Taiwan and South Korea and set up mutual funds in which foreign capital could be invested. China concluded that issuing B shares posed fewer technical difficulties and that it had neither the personnel nor the experience to manage complicated mutual funds. Therefore, it opted for the B shares method of attracting foreign capital.¹¹¹ In December 1991, the Shanghai Vacuum Electron Devices Corporation became the first enterprise to issue one million B shares. Shortly thereafter, in Shenzhen, China Southern Glass Corporation issued sixteen million B shares for sale abroad. The two B shares were put on the market in February 1992. Today, the total volume of all B shares on both stock exchanges is still relatively small.

The Shanghai and Shenzhen regulatory regimes make special provisions for B shares.¹¹² In addition to meeting the requirements for issuing A shares, B share-issuing companies must have foreign currency annual incomes sufficient to pay a dividend.¹¹³ B shares are issued mainly through two channels. One is local securities firms that are officially designated as responsible for issuing B shares to foreign traders in China. The other is a number of specially authorized securities traders abroad which

109. Shenzhen previously used Hong Kong dollars for foreign currency clearance for its B shares. Starting early 1993, it has used U.S. dollars to replace Hong Kong dollars for foreign currency clearance of B shares.

110. B shares are issued to and purchased by three categories of foreigners: (1) legal and natural persons from Hong Kong, Macao, and Taiwan; (2) legal and natural persons from foreign countries; and (3) other overseas legal and natural persons authorized by the administrative authority. See SHANGHAI SHI RENMINBI TEZHONG GUPIAO BANFA [Shanghai Renminbi Special Shares Administration Methods] art. 14 (promulgated Nov. 22, 1991), in *ZHONGGUO GUSHI ZONGLAN*, *supra* note 16, at 415, 417.

111. See Hu Ye-pi, *B Shares—A New Star in the Opening of China's Stock Market to the Outside World*, CHING-CHI TAO-PAO [ECONOMIC REPORTER] (HK), May 4, 1992, at 3, translated in JPRS-CAR-92-080, Oct. 22, 1992, at 38.

112. It is observed that the initial B shares legislation in Shanghai demonstrated "significant hesitancy, though gradually giving way to a more supportive position, whereas in Shenzhen where support for foreign participation was evident over a much longer period of time, its B shares regulations were far ahead of Shanghai in basic policies and outlook." See Potter, *supra* note 86, at 81-82.

113. See Shanghai Renminbi Special Shares Administration Methods, *supra* note 110, art. 9.

can issue B shares to overseas investors.¹¹⁴ The second channel is more widely-used. Foreign securities firms must meet strict requirements to become agents or overseas underwriters.¹¹⁵ The regulatory framework governing B shares reflects China's leaders' objectives of bringing in more foreign capital, and making the Chinese stock markets more international in their operations while simultaneously maintaining government control over them.

B. CHINESE CHARACTERISTICS VERSUS INTERNATIONAL PRACTICE

In establishing its securities system, China has borrowed from Western models. Many of the provisions in the Shanghai and Shenzhen securities laws are drawn from U.S. securities laws. These include provisions governing stock registration, disclosure, trading, insider information, broker-dealers, and administration of the stock exchanges. China has also borrowed from Hong Kong, inasmuch as China's SCSC is modeled after Hong Kong's Securities and Futures Commission ("SFC"), which was set up under a centralized system of "one agency, one market."

Nevertheless, differences abound between Chinese and Western securities laws and practice. U.S. securities laws, which follow common law tradition, are like a huge web—a plethora of federal laws and state laws.¹¹⁶ Chinese securities laws, at the national level, are too general and sketchy. The local rules, which are more specific and detailed, have only limited jurisdiction and sometimes conflict with each other. A more specific and uniform securities law at the national level is urgently needed.¹¹⁷

One of the most striking structural differences between Chinese and Western securities laws stems from the unique functions

114. On the Shanghai B share authorized underwriters list, there are three Chinese securities firms and 23 foreign securities traders, including Swiss Bank (Asia) Ltd., Solomon Brothers (HK) Ltd., Merrill Lynch (HK) Ltd., and Sun Hung Kai Investment Services Ltd. See *Ershi San Jia Jinwai Zhenquan Gongsi Zai Shanghai Gushi She Jiaoyi Xiwei [Twenty-three Foreign Securities Firms Obtained Seats in the Shanghai Stock Exchange]*, RENMIN RIBAO (overseas ed.), May 12, 1993, at 2. On the Shenzhen list, there are five local securities firms and 13 foreign securities firms, including Lyonnais Securities Corp. and Swiss Bank (Asia) Ltd.

115. See SHANGHAI RENMINBI TEZHONG GUPIAO GUANLI BANFA SHISHI XIZE [Implementation Rules of Shanghai Renminbi Special Shares Administration Method] arts. 12-16, in ZHONGGUO GUSHI ZONGLAN, *supra* note 16, at 419, 421-22.

116. Dan Fenno Henderson, *Security Markets in the United States and Japan: Distinctive Aspects Molded by Cultural, Social, Economic, and Political Differences*, 14 HASTINGS INT'L & COMP. L. REV. 263, 267-68 (1991).

117. The first national securities law has undergone several drafts. But it was not submitted for approval during the 8th National People's Congress convened in March 1993. Instead, the State Council and the Securities Supervision and Control Commission promulgated two regulations for stock issuance and trading. See *supra* note 27.

and operations of China's shareholding companies. As we have seen, these shareholding companies, which are either restructured from previous state ownership or newly formed, issue three kinds of shares. The bulk of the shares, namely the state and the legal person shares, are not trading in open markets, thus limiting the vitality and rigor of the market.¹¹⁸ Activities such as mergers and acquisitions, tender offers and takeovers are almost impossible where public ownership of shares is so widespread.

Moreover, as the state or a state-owned enterprise remains the largest shareholder in the new shareholding company, the company's activities, if not business as usual, have not changed to reflect fully those of a shareholding company in the developed countries. Thus, using the term privatization may exaggerate the impact of the securities program on China's system of public ownership. The ongoing process may be better characterized as corporatization, where a former state-owned enterprise is restructured into a corporation that has some division of ownership and management, more in line with international corporate management norms. Thus, there may be less emphasis on the social welfare of enterprise employees and more stress on the profit interests of its owners, mainly its shareholders. For example, many Chinese enterprises, after the restructuring, may have to relinquish most of their public social welfare functions, such as providing cafeterias, hospitals, and pre-school childcare for their employees.¹¹⁹

Most Chinese officials and scholars agree that the securities laws and regulations must have strong "Chinese characteristics." Yet, China's securities laws and regulations do not adequately protect shareholders, especially the minority shareholders, and, in some key respects, conflict with standard practice in the international securities field. If China is to extend its direct fund raising channel to the international financial markets, its laws, regulations, and practices must be compatible with international standards. Therefore, China's scheme of issuing three kinds of shares for one company with state shares and legal persons shares non-tradable—so important to preserve the "Chinese characteristics" of public ownership—may have to change.

118. Participants in a recent international conference on securities market development in China agreed that the most prominent issue to be resolved was the non-tradability of the public shares, including the state shares and the legal person shares, in the stock exchanges. See *Speed Up the Development of the Chinese Securities Market*, RENMIN RIBAO (overseas ed.), Apr. 17, 1993, at 1.

119. See *China Will List Nine Companies in Hong Kong.*, *supra* note 4.

IV. SECURITIES DEVELOPMENT IN CHINA: IMPACT AND PROSPECT

So far, the shareholding system and the stock markets in China have been gathering momentum, though the securities program as a whole plays only a limited role in China's overall economy.¹²⁰ Only one in two thousand enterprises is involved, and shareholding capital accounts for less than one-one thousandth of all funds. Shareholding companies are characterized as "three mores and three fewers"—that is, more are small and medium-sized enterprises and fewer are large enterprises; more are collective enterprises, and fewer are enterprises owned by the whole-people; and more are enterprises issuing internal or controlled shares, and fewer are enterprises issuing shares to the public.¹²¹ Nevertheless, the shareholding system and the stock markets will inevitably have a significant impact on both China's economy and its ownership system.

From a microeconomic point of view, the shareholding system is retransforming China's enterprises. In a shareholding enterprise, top authority resides with the shareholders and the board of directors. Such a structure will inevitably undermine the "departmental ownership system" under which government departments at all levels, from the center to the local, have run things in the name of socialist public ownership for many years. After an enterprise has switched to the shareholding form, the new shareholding company will enjoy some decision-making power in its operations regardless of whether the majority of shares in the enterprise is publicly, collectively, or privately owned. Though the structure of Chinese enterprise may not change drastically, it is all but certain that government intervention will be reduced, as the separation of government administration from enterprise management starts to take hold. Moreover, enterprise managers will be less accountable to government officials than to shareholders, the board of directors, and the market (as reflected in the price of the stock). In this respect, the introduction of the shareholding system can be viewed as a "revolution" in the initial stage of China's socialism.

From a macroeconomic point of view, two significant changes are taking place in China's ownership system. First, the single ownership system has been abandoned: a multi-ownership

120. In 1992, among the nearly four hundred companies which were approved to become shareholding companies, shares of sixty-nine companies were actually listed in the stock market. See *China's Social and Economic Development Has Eight Big Changes*, RENMIN RIBAO (overseas ed.), Feb. 19, 1993, at 1.

121. See Xu Zhantao & Cheng Boming, *Improving China's Financial Market*, JINRONG SHIBAO [FINANCIAL TIMES], Oct. 21, 1991, at 3, translated in JPRS-CAR-92-001, Jan. 14, 1992, at 29, 31.

system has emerged with collectively or privately-owned enterprises supplementing the whole-people owned system. Second, under the shareholding system, a variety of ownership elements are allowed to coexist as a mix within one enterprise which encompasses state shares, enterprise shares, and private shares owned by the individuals, whereas, in the past, a single enterprise could only take on one ownership form. Today, among the multi-ownership elements within one shareholding company, co-operation as well as competition are inevitable.

With respect to economic development, the awakening stock markets have promoted regional economic development, especially in Shanghai and Shenzhen where the stock exchanges are in operation. In particular, the Pudong development in Shanghai, China's most ambitious project of economic reform and open policy in the 1990s, needs roughly U.S.\$10 billion.¹²² Stock markets have become a viable option for raising the massive amount of capital at home and abroad needed for the Pudong development project.

The development of stock markets has also opened China more widely to the outside world. The issuing of B shares and the listing of stocks overseas have enabled China to face the risks as well as the opportunities of the international securities market. In particular, Hong Kong's active participation in mainland China's securities program has made it an indispensable co-partner in China's securities projects. A closer link between the mainland and Hong Kong is not only favorable to the economic development on both sides but also boosts Hong Kong's confidence in China, which is scheduled to reassert sovereignty over Hong Kong in 1997. With billions of dollars already invested in Hong Kong by the mainland and vice versa, Hong Kong is regarded as the hen that can lay "golden eggs" for the mainland.¹²³

Since the beginning of 1993, significant changes have occurred in China's securities program. Events in four fronts reveal the primary areas of future development. First, the National People's Congress (NPC)—China's legislative body—is about to approve and promulgate the Securities Law, making it the first piece of legislation at the national level on the securities industry in China.¹²⁴ This indicates that what has been called the "experi-

122. Caspar W. Weinberger, *Developing the New Shanghai*, FORBES, Nov. 26, 1990, at 29.

123. See Sheryl WuDunn, *Hong Kong Shrugs as China Fumes*, N.Y. TIMES, Mar. 18, 1993, at D1, D7; see also *It's Already 1997 in Hong Kong*, ECONOMIST, Dec. 18-24, 1993, at 36, 36-38.

124. *Zhongguo Jiang Chutai Yipi Jingji Falu [China Is Going to Promulgate Several Economic Laws]*, RENMIN RIBAO (overseas ed.), Nov. 19, 1993, at 3; see also *Renda Changweihui Shengyi Zhengquanfa Yusuanfa Cao'an [NPC Standing Com-*

mental" chapter for the infant securities program is probably complete. The promulgation of the new Securities Law will improve and strengthen the securities regulatory regime to the benefit of the overall growth of the securities industry in China.

Second, the central securities regulatory agency is becoming more assertive in regulating and enforcing the securities rules and regulations. In October 1993, the China Securities Regulatory Commission ("CSRC") imposed a one million yuan fine against the Bao'an Company of Shenzhen for violating disclosure requirements in acquiring more than five percent of the Shanghai Yanzhong Corporation's stocks in the Shanghai Securities Exchange.¹²⁵ Two months later, in December 1993, the CSRC issued penalties to six stock-issuing companies for violating proxy rules in their stock redistributions.¹²⁶ Meanwhile, the CSRC ordered that the trading of six "legal persons" shares be stopped.¹²⁷

Third, more and more Chinese companies are gaining access to international securities markets by listing and trading their stock in the Hong Kong and New York stock exchanges. Listing of the Shanghai Petrochemical Company (a global combined offering including the issuance of American Depository Receipts in the New York Stock Exchange)¹²⁸ and the Tsingtao Beer Company in the Hong Kong Stock Exchange during 1993 represent the most visible hallmarks of this development.¹²⁹ The CSRC

mittee Discussing the Drafts of the Securities Law and the Budget Law], RENMIN RIBAO (overseas ed.), Dec. 24, 1993, at 3.

125. See *Jiu Bao'an Shanghai Gongsi Daliang Goujin Yanzhong Gupiao Yishi, Zhongguo Zhengjianhui Zuochu Caijue* [The CSRC Makes Decision on Bao'an Company's (Shanghai) Purchase of the Yanzhong Stocks], RENMIN RIBAO (overseas ed.), Oct. 25, 1993, at 2. For a discussion of recent takeovers in the Shanghai market, see Joseph Kahn, *Takeover Fever Grips Shanghai Market Again on News of Raid on Local Firm*, ASIAN WALL ST. J. WKLY., Nov. 15, 1993, at A20.

126. *Zhongguo Zhengjianhui Dui Shangshi Gongsi Zuochu Guiding* [The CSRC Establishes Rules for the Listed Companies], RENMIN RIBAO (overseas ed.), Dec. 28, 1993, at 2.

127. *Zhongguo Zhengjianhui Riqian Xuanbu: Tingzhi Liuzhi Xin Faren Gu Jiaoyi* [CSRC Announces that Six New Legal Persons' Shares Trading To Be Stopped], RENMIN RIBAO (overseas ed.), Dec. 28, 1993, at 2.

128. See *Equities Issues This Week*, N.Y. TIMES, July 19, 1993, at D4; see also *Shanghai Petrochemical Files for ADR Offering*, WALL ST. J., July 8, 1993, at C21 (The author worked on the Shanghai Petrochemical ADR offering in New York and Shanghai during the summer of 1993.). For post-issuance coverage of the Shanghai Petrochemical Company, see Joseph Kahn, *A Revitalized Shanghai Petrochemical Finds No Escape from Central Planning*, ASIAN WALL ST. J. WKLY., Jan. 3, 1994, at A17, A17-A18.

129. See *New China Policy Has Slight Impact on Stock Market*, ASIAN WALL ST. J. WKLY., July 19, 1993, at A23.

plans to choose another batch of large state-owned enterprises to issue stocks abroad in 1994.¹³⁰

Fourth, and perhaps most significant, China will seriously tackle the property rights issue by starting to transform large numbers of state-owned enterprises in 1994. The recent Third Plenary Session of the 14th Central Committee of the CPC, while sketching out a broad program of establishing "a socialist market economy," gave priority to the establishment of a modern and efficient enterprise system.¹³¹ State-owned enterprises still play an important role in China's economy.¹³² The direction and transformation of China's state-owned enterprises will be crucial to China's economic development into the twenty-first century.

CONCLUSION

China has been pursuing an ambitious securities program since the late 1980s, especially during the early 1990s. Theoretical circles, after three rounds of debate extending over almost a decade, have come to realize the tremendous need for, and potential benefits from, developing a shareholding system and stock markets. But members of the theoretical circles disagree about how fast and how far China should pursue the securities program. Some want to speed up and extend the securities development, making it a core strategy for China's economic reform into the next century. Others are more cautious and propose a moderate and slower-developing securities program. Still a few renounce the securities program as a reflection of "bourgeois liberalization."

So far, the moderate reform group has prevailed. China's securities program is still experimental, limited, and under central supervision and control. Development of the securities system will be retarded if reforms are not made in other sectors of the economy, including establishment and perfection of markets in labor, capital, and the means of production. Yet, one thing is quite certain. China will not, at least in the short term, pursue the "liberal" proposal to utilize the securities system to privatize state assets. China's securities program and regulatory regime

130. *State Firms to Issue Shares Abroad in 1994*, BEIJING REV., Nov. 29-Dec. 5, 1993, at 28; see also Kathy Chen & Julia Leung, *China to Unveil More Firms Seeking Listing Overseas*, WALL ST. J., Jan. 10, 1994, at A8.

131. *Party Session Specifies Goals for Reform*, BEIJING REV., Nov. 22-28, 1993, at 5, 5-6; see also *Decision of the CPC Central Committee on Some Issues Concerning the Establishment of a Socialist Market Economic Structure*, BEIJING REV., Nov. 22-28, 1993, at 12, 14-17.

132. In 1992, out of the total of 37,065 industrial output value (100 million yuan), the state-owned industries occupied 17,824, nearly half of the total output value. See *China: 15 Years of Reform*, BEIJING REV., Oct. 25-31, 1993, at 20, 23.

may borrow from Western practice, but China insists on retaining its "distinctive characteristics" of dominant public ownership of its shareholding system.

Thus, the architects of China's securities program are riding two horses, so to speak. One horse wishes to go in the traditional direction of public ownership; the other horse wants to take an untrod path toward privatization. Though complete privatization is unlikely to occur in China in the immediate future, the impact of its partial realization should not be overlooked. As we have seen, introduction of the shareholding system will inevitably lead to a more mixed and globalized economy. Indeed, China has already progressed in that direction. Therefore, the day might not be too far off when China may find that it must ride only one horse.