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Reforming State Enterprises in China: The Case for Redefining Enterprise Operating Rights

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". . . [M]ix up the clay and mold it again, to recreate another you and to remake another me. From now on, I may say your clay consists of mine and mine of yours."[1]

I. INTRODUCTION

Over the past decade, the People's Republic of China ("China") has undertaken economic and legal reforms that have been quite impressive.[2] To carry out these reforms, the government has implemented many measures designed to boost the productivity of the public[3] and private[4] sectors. In particular, state enterprises[5] have

1. This is part of an ancient love song entitled "Ni Nong Wo Nong" that comes from Chinese folklore (translated by the author). It has no definitive origin but is frequently attributed to a thirteenth century Yuan dynasty artisan named Guan Daosheng. According to legend, Guan, the wife of a statesman named Zhao Ziang, composed the verse when she learned that her husband planned to take a concubine. After reading the verse, Zhao was so moved that he decided to drop the idea of a concubine. See research memorandum from Tsai Yu, associate professor at National Taiwan University, to Wallace W.Y. Wang (Nov. 15, 1992) (on file with the Journal of Chinese Law). The author would like to thank Professor Tsai for her research assistance concerning the origin of this poem.

The clay couple metaphor applies aptly to the entangled property relationship that exists between the state and state enterprises in China.

2. See generally, Harry Harding, China's Second Revolution: Reform after Mao, 101-30 (1987); James V. Feinerman, Economic and Legal Reform in China, 1978-91, Problems of Communism, Sept.-Oct. 1991, at 62.

3. Since 1984, state enterprises have been granted greater power over the production, pricing, and distribution of output that exceeds quotas. See, e.g., Roger H. Gordon & Wei Li, Chinese Enterprise Behavior Under the Reforms, in Chinese Economic Reforms, 1979-89: Lessons for the Future, 81 Am. Econ. A. 202 (1991); Dwight H. Perkins, Markets Versus Plans: The Key Role of Enterprise Manager Behavior, in 1 Joint Econ. Comm., 102d Cong., 1st Sess., China's Economic Dilemmas in the 1990s: The Problems of Reforms, Modernization, and Independence 160, 162 (Comm. Print 1991).

4. A key aspect of the economic reforms has been to make it easier for collective enterprises (*jiti qiye*) and individual household businesses (*getihu*) to set up their own firms outside of the state planning structure. For a discussion of such private enterprises in China, see Alison W. Conner, To Get Rich is Precarious: Regulation of Private Enterprise in the People's Republic of China, 5 J. Chinese L. 1 (1991).

5. "State enterprise," refers to state-owned enterprises. For the purpose of clarity, state-owned enterprises should be distinguished from state-operated enterprises or state-run enterprises. In the Chinese context of state-owned enterprise, the state not only controls the enterprises but also legally owns the major means of production managed by the enterprises. Whereas, the latter category refers to independent entities that are controlled by the state through majority equity shareholdings or through de facto control (administrative fiat, etc.) For a discussion of the appropriate boundary between public and private corporations, see John Vickers & George Yarrow, Economic Perspectives on Privatization, J. Econ. Persp., Spring 1991, at 111, 111-13.

received special attention, due to both their importance in the economy[6] and the kinds of problems which confront them.[7] Of all the reform measures concerning the state enterprises, attempts to promote greater autonomy in their management have been among the most difficult to implement effectively.[8]

In many socialist countries, reforming state enterprises has been one of the most intractable economic problems.[9] Reform has been difficult because it calls for more than the government's good faith, policy pronouncements and even administrative fiat. It requires fundamental legal and institutional changes that are of the most significant ideological, political[10] and economic[11] consequence. For instance, Chinese state enterprises are, in a sense, "vast kingdoms of

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6. Despite the tremendous growth of the private sector, state enterprises remain the economic backbone of China. State enterprises produced 52.8% of the nation's industrial output in 1991, Wall St. J., Mar. 2, 1992 at 9, col. 1; The value of China's state-owned assets totalled 2,271.3 billion yuan (about $436.788 billion (U.S.)) by the end of 1990, China's State-Owned Assets Valued at $436.8 Billion, Foreign Broadcast Information Service-Daily Report, China [FBIS-China], Apr. 21, 1992, at 40.

7. More than one third of the large and medium-sized enterprises are losing money and are billions of dollars in debt. See China Expands Capitalist-Style Enterprise Reform, Agence France Presse, Feb. 13, 1992, available in LEXIS, Nexis library, AFP file. One recent example of the huge debt problem is the so called "triangular debt," where one money-losing state enterprise borrows from another. "The three major causes of debt defaults are excessive investment in fixed assets, stockpiled goods and losses by state enterprises." See, China Searches for a Solution to Triangular Debt, Reuters Money Report, Mar. 9, 1992, available in LEXIS, Nexis library, MONRPT file.

8. See, e.g., James B. Stepanek, China's Enduring State Factories: Why Ten Years of Reform Have Left China's Big State Factories Unchanged, in 1 Joint Econ. Comm., 102d Cong., 1st Sess., China's Economic Dilemmas in the 1990s: The Problems of Reforms, Modernization, and Independence 440 (1991).

9. For a discussion of the problems regarding state enterprise reform encountered by East European countries, see, e.g., Stanley Fischer & Alan Gelb, The Process of Socialist Economic Transformation, J. Econ. Persp., Fall 1991, at 91, 98-100; Thomas Wolf, The Lessons of Limited Market-Oriented Reform, J. Econ. Persp., Fall 1991, at 45, 50-52.

10. For example, it has been noted that the Chinese state enterprise is, among other things, a political institution. "As a unit of government administration, it provides a variety of socio-political services that are entirely missing" in capitalist countries such as Japan and the United States. See Andrew G. Walder, Communist Neo-Traditionalism: Work and Authority in Chinese Industry 29 (1986).

11. A recent example is Russia. Treading a delicate path between reform and avoiding destruction of the country's fragile economy, the Russian government has recently changed its reform measures on state enterprise by providing additional funds to state enterprises in order to prevent mass bankruptcies and postponement of company privatization. See Russia Says it is Slowing Pace of Reform, S.F. Chron., Apr. 25, 1992, at 1, col. 3.

welfare management"[12] serving their beneficiaries — workers and their families. One major consequence of pushing enterprises to the market would be to break the "iron rice bowl," a concept whereby workers are guaranteed a job with benefits, housing and free medical care for life. Since this kind of reform goes directly to the heart of entitlements enjoyed by enterprise workers, it is likely to be met with resistance. Furthermore, reform has been difficult to implement because it involves so many interrelated issues (e.g., property rights, organizational change, administrative supervision, welfare entitlements and market mechanisms). As a result, it is at times difficult to sort out all the relevant issues and to establish a proper order for reform.[13] Because of the intractable and complicated nature of the reform process, governments have occasionally taken reform measures that merely graze the surface of the problem. This is particularly the case with respect to the laws and policies governing Chinese enterprise property rights.

In China, the property rights system reflects not only socialist ideology but also the economic strategy of the reform era. To promote greater autonomy in enterprise management, the government has established the principle of "separating ownership rights from operating rights" and promulgated regulations incorporating this principle. The separation of ownership rights from operating rights in China should be distinguished from the separation of ownership and control that is prevalent in Western corporations, such as the so-called Berle/Means corporations in the United States. Corporate America is based on the premise that a corporation is an independent legal entity that owns the assets under its management. Thus, in the American corporate context, "ownership by stockholders" is shorthand for the possession of organizational control over the corporation, rather than direct property rights control over corporate assets.[14] In China, where the major means

12. Letter from Dr. Ramon H. Myers, Senior Research Fellow at the Hoover Institution, to Wallace W. Y. Wang (June 2, 1992) (commenting on an initial draft of this article) (on file with the Journal of Chinese Law).

13. For instance, in summarizing the Czechoslovakian experiences with economic reform, President Havel commented that: "Each day brings new problems, and each day we realize how interrelated they are, and how difficult it is to establish the proper order in which to deal with them." Peter Murrel, Symposium on Economic Transition in the Soviet Union and Eastern Europe, J. Econ. Persp., Fall 1991, at 3.

14. The owners of a corporation share two formal rights: the right to appropriate its residual earnings and the right to control it. Stockholders are paid last, after debt investors, employees and other investors with relatively fixed claims. Thus, stockholders are "residual" claim holders in the sense that they receive only what is left over; but they are not permitted to take corporate assets

of production are owned by the state, the key issue is: what kind of asset management rights does a state enterprise have over state-owned assets?

Although the issue of enterprise autonomy in socialist countries has frequently arisen during periods of economic transition to market economies,[15] the concept of "separating the two rights" in China is unique. Not surprisingly, the nature and extent of enterprise operating rights have been a source of controversy in China.[16] Are they, for example, independent property rights or, as claimed by some Chinese theorists, rights with Chinese characteristics? Over a dozen theories have been espoused as possible explanations of enterprise operating rights in China. This question is further complicated by the debate over a related issue: whether the conversion of state enterprises into equity stock corporations is a feasible way to ensure enterprise autonomy. In considering the legal concept of operating rights, however, regulators and theorists alike have, intentionally or inadvertently, avoided the crux of the problem — the entangled property relationship that exists between the state and the state enterprise.

The purpose of this article is to examine the nature of operating rights, to untangle the state-enterprise property relationship, and to propose approaches to redefine enterprise operating rights. In doing so, this article will analyze current statutory law in China[17] and inquire

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out of a corporation before it is liquidated. In addition, sometimes the owners of such corporations do not in fact control the corporations because they exercise little effective authority over corporate management. It is this imposition of a separate legal layer which creates the ownership vs. control (i.e., governance) issue. The separation of ownership and control in the U.S. was first identified by Adolf A. Berle and Gardiner C. Means in their ground-breaking book, The Modern Corporation and Private Property (1932).

15. One recent example is Yugoslavia, which for many years appeared to offer a middle road between capitalism and Soviet central planning. In an effort to move toward Western-style capitalism, Yugoslavia faced the problem of deciding how to change the enterprise ownership and management system. See Saul Estrin, Yugoslavia: The Case of Self-Managing Market Socialism, J. Econ. Persp., Fall 1991, at 187, 194. For a discussion of economic transition in the Soviet Union and Eastern Europe, see Murrel, supra note 13, at 3.

16. The controversy even existed during the drafting of the Civil Law in the early 1980s and has continued into the 1990s. See infra notes 87-117 and accompanying text.

17. In studying Chinese Law, it is at times difficult to take a strict constructionist approach. The reasons are obvious. Firstly, after only a decade of legal reform Chinese law is in flux amidst a developmental stage. Secondly, in China legal construction must take ideology and policy pronouncements into consideration. Thirdly, while a socialist state, China claims to follow the Continental civil law tradition (at least in the Civil Law context). As such, observers are sometimes torn between two irreconcilable schools of statutory interpretation: one from a socialist-dominated perspective and the other from a civil law approach. For problems encountered in

into the nature of property rights. Part I will address the law and policies regulating property rights and state enterprises. Part II will analyze the concept of operating rights and the various theories advocated by Chinese theorists. Part III will discuss the costs of the current operating rights and possible reform measures such as equity stock enterprises. Part IV will first revisit the concept of property rights and then propose approaches to disentangle the state-enterprise property relationship. In addition, Part IV will articulate policy considerations involved in reforming state enterprises, including workers-as-welfare-claimants and privatization of state enterprises.

II. LAWS AND POLICIES ON STATE ENTERPRISES

A. *State Ownership and Property Rights System*

According to socialist theory in China, only the state or collective entities can carry out large-scale economic activities. China's Constitution provides for public ownership of the means of production, namely, ownership by the whole people and collective ownership by the working people;[18] any significant private ownership of the means of production is eliminated. Even with the economic reforms of the last decade, these two basic forms of constitutionally mandated ownership have only been mildly eroded.[19] In an effort to grant some management powers to state enterprises, the Constitution further provides that state enterprises have decision-making power in operations and management within the limits prescribed by law, on the condition that they submit to the unified leadership of the state and fulfill all their obligations under state plans.[20]

The General Principles of Civil Law of the People's Republic of China promulgated in 1986 established a systematic and comprehensive

conducting Chinese legal studies, see generally Stanley Lubman, Studying Contemporary Chinese Law: Limits, Possibilities and Strategy, 39 Am. J. Comp. L. 293 (1991).

18. Constitution of the People's Republic of China (adopted Dec. 4, 1982) [hereinafter Chinese Constitution], art. 6, reprinted in 52 Peking Rev. 10-29 (1982). "Means of production" include items such as mineral resources and land. Id. art. 9-10.

19. For a discussion of the economic reforms and the forms of ownership, see, e.g., Gordon & Li, supra note 3, at 202-6. See also Howard Chao & Xiaoping Yang, Private Enterprise in China: The Developing Law of Collective Enterprises, 19 Int'l Law. 1215 (1985).

20. Chinese Constitution, supra note 18, art. 16.

legal system.[21] "Despite any 'Chinese characteristics' that might be found elsewhere in [the Civil Law], its theoretical framework is firmly rooted in the Romanist legal tradition."[22] It "regulates property relations and personal relations between subjects of equal status — between citizens, between legal persons, and between citizens and legal persons."[23] Pursuant to the Civil Law, there are four categories of civil rights: (1) "ownership and property rights related to ownership," (2) "obligations," (3) "intellectual property rights" and (4) "personal rights."[24]

As a fundamental law regulating property relations, the Civil Law has played an important role in defining the framework of property rights for economic relations. Under article 71, ownership rights over property are defined as the rights of possession, use, profit and disposition.[25] The system of ownership is further divided into three categories: "by the whole people," "by collective organizations of the working masses" and "by citizens."[26] After setting out ownership rights and related matters, the Civil Law enumerates five "property rights related to ownership" in articles 80 to 83.[27]

Chief among these five categories of property rights related to ownership are the "operating rights" (*jingying quan*)[28] enjoyed by a

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21. General Principles of Civil Law of the People's Republic of China (adopted Apr. 12, 1986, effective Jan. 1, 1987) [hereinafter the Civil Law], reprinted in Guowuyuan Gongbao [State Council Gazette], at 371-93 (1986), translated in 34 Am. J. Comp. L. 715 (1986).

22. Edward J. Epstein, The Theoretical System of Property Rights in China's General Principles of Civil Law: Theoretical Controversy in The Drafting Process and Beyond, 52 Law & Contemp. Probs. 177, 178 (1989). Ideological considerations aside, the "theoretical framework of China's Civil Law is rooted in the Romanist legal tradition as interpreted by the Pandectists and borrowed from them by Japan and China before 1949." Id. at 178. German law "had a profound effect on the drafting of the 1896 Japanese Civil Code, and it was largely through Japan that the Civil Code of the Republic of China [— the predecessor of the People's Republic of China in Mainland China —]. . . acquired its terminology for the classification of property rights." Id. at 183.

23. Civil Law, supra note 21, art. 2.

24. Civil Law, supra note 21, arts. 71-105.

25. Civil Law, supra note 21, art. 71 provides that "Ownership means an owner's right in accordance with law to possess, use, benefit from, and dispose of his own property."

26. Civil Law, supra note 21, arts. 73-75.

27. Civil Law, supra note 21, arts. 80-83.

28. *Jingying quan* in Chinese means "the right to operate." However, if we consider the context in which this term is used, it probably means something closer to "asset management rights." This article will use the term "operating rights" because (1) it is the literal translation, and (2) it can distinguish itself from management rights that exist in the American corporate context. See supra note 12 and accompanying text.

state-owned enterprise ("state enterprise").[29] Although under article 73 state properties belong to "all the people," the state — as the representative of all the people — in actuality exercises ownership rights over them.[30] Pursuant to article 82, operating rights are defined as "[t]he right[s] enjoyed by a state-owned enterprise to operate according to law state property that has been given to it to operate and manage."[31] Operating rights are designed to define and realize enterprise autonomy in the socialist planned economy.[32]

These five property rights related to ownership are important in the sense that they implicitly lay out the concept of "rights in things" (*wuquan*) found in Continental civil law systems.[33] Under most civil law systems, rights in things are contrasted with other rights such as contractual rights (obligations). Rights in things arise by virtue of some legally recognized form of domination over a thing. Rights in things are distinguished from other property rights by two important features. First, they confer rights on a particular person rather than a class of persons. The object of the right is a "thing," typically a piece of physical property. Second, rights in things allow for the control of an object to the exclusion of the rest of the world. The holder of such a right has a remedy against the object itself, not merely an action in damages.[34] These civil property rights perform an important economic function because they provide a basis to define the legal rights of productive entities to control the publicly owned means of production.

Another legal relation governed by the Civil Law is agency. Pursuant to article 63, agents perform civil legal acts in the name of the

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29. The other four categories of property rights are: 1. the right of state-owned or collective units to "use and benefit from" land owned by the state or things on the land owned by the state; 2. the right acquired by contract, of citizens or collectives to operate publicly owned land and things on the land; 3. The right of state or collective units or citizens to exploit natural resources; 4. limitation of property rights necessary for the conduct of "neighborhood relationships." Civil Law, supra note 21, arts. 80-81, 83.

30. See Tong Rou, The General Principles of Civil Law of the PRC: Its Birth, Characteristics, and Role, 52 Law & Contemp. Probs. 151, 169 (1989).

31. Civil Law, supra note 21, art. 82.

32. The "right to operative management" was first adopted in the Soviet Civil Legislation Principles in 1961. For a review of the concept of operative management rights in socialist countries, see Wang Liming & Liu Zhaonian, On the Property Rights System of the State Enterprises in China (Fu Xiaoshuang & Wu Yanlei trans.), 52 Law & Contemp. Probs. 19 (1989).

33. Although the terminology "rights in things" does not appear in the Civil Law, the theoretical concept is still hard at work. See Epstein, supra note 22, at 184.

34. See, e.g, E.J. Cohn, Manual of German Law, ch. 3 (2d ed., 1968).

principal within the limits of their authority.[35] Principals bear civil liability for acts performed by agents on their behalf.[36]

B. *Regulation of State Enterprises*

The Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People, passed by the People's Congress on April 13, 1988, was a major shift in the course of China's legal and economic reform.[37] Hailed as a "legislative landmark" in China's history,[38] it was intended to clarify the vague legal status of state enterprises and to afford considerable independent decision-making power to these enterprises.[39] Divided into eight chapters, the Law resolved a long-running debate between the Communist Party reformists and conservatives.[40]

The first chapter of the State Enterprise Law clarifies the scope of the law's application, and limits it to state-owned industrial enterprises.[41] Article 7 makes clear that the manager bears responsibility for the enterprise's management, and article 8 states the Communist Party's role as guarantor and implementor of Party principles in the enterprise.[42] Chapter two governs the establishment of enterprises; pursuant to this chapter, enterprises must comply with relevant rules and must register with the appropriate administrative authorities.[43]

The most important chapter of the new law, chapter three, sets forth the rights and obligations of the enterprise. It grants an enterprise

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35. Civil Law, supra note 21, art. 63.

36. In addition, article 64 of the Civil Law provides that agency includes agency by agreement, agency by operation of law, and designated agency. Civil Law, supra note 21, art. 64.

37. Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People (adopted Apr. 13, 1988) [hereinafter the State Enterprise Law], reprinted in China Ls. for Foreign Bus. (CCH Austl.), at 313-534 (1988).

38. Wang Baoshu, Lun Quanming Suoyouzhi Gongye Qiyefa zai Qiye Lifa Shang de Tupo [On the State Enterprise Law as a Major Breakthrough in Legislative History Concerning Enterprise], 4 Zhongguo Faxue [China Jurisprudence] 3 (1988).

39. See James V. Feinerman, The Evolving Chinese Enterprise, 15 Syracuse J. Int'l L. & Com. 203, 207 (1989).

40. This law had been on the drawing board for over nine years. For a brief review of the legislative history of the law, see Yang Xiaobing, Enterprise Law: A Milestone for Reform, Beijing Rev., May 2-8, 1988, at 24.

41. State Enterprise Law, supra note 37, arts. 1-2.

42. State Enterprise Law, supra note 37, arts. 7-8.

43. State Enterprise Law, supra note 37, arts. 16-21.

the right to plan its own production; to request adjustments in mandatory plans and to reject additional assignments outside mandatory plan quotas; to set its own prices; to maintain budgetary control over retained funds (retained earnings); to control and dispose of fixed assets; to fix wages and bonuses; and to hire, fire and redeploy personnel.[44]

Chapters four and five outline the roles of factory directors, staff and workers in state enterprises.[45] Pursuant to chapter four, enterprise directors are given some discretionary power, but subject to significant restrictions: an enterprise director has the power to draft plans for the enterprise, subject to the approval of the workers and of various government departments; to establish the administrative structure of the enterprise; to appoint, remove, reward or punish senior-level cadres with government approval; to motivate workers by rewarding and penalizing them; and to make decisions on important issues with the help of an administrative committee.[46]

Chapter five, titled "Workers and Workers' Representative Assembly," gives workers some power over the management of the state enterprise which employs them.[47] Through the Workers' Representative Assembly, employees are entitled to evaluate the administrative leaders of an enterprise; to make suggestions regarding the leaders' rewards, penalties, appointment and removal; to elect and remove the enterprise director subject to government approval; to discuss and decide on plans regarding workers; and to discuss and offer suggestions on the enterprise's plans.[48] Although the statutory language seems to assure the workers of representation in the management of the state enterprise, in reality, the Workers' Representative Assembly sometimes provides a channel for Party officials to wield power.[49]

Chapter six clarifies the relationship between the enterprises and the government.[50] A supervisory government department issues directive

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44. State Enterprise Law, supra note 37, arts. 22-43. For a discussion on some of the key provisions in chapter three which are relevant to operating rights, see infra notes 65-80 and accompanying text.

45. State Enterprise Law, supra note 37, arts. 44-54.

46. State Enterprise Law, supra note 37, arts. 44-48.

47. State Enterprise Law, supra note 37, arts. 49-54.

48. State Enterprise Law, supra note 37, arts. 49-54.

49. The communist party sometimes flexes its power through the Assembly found within each enterprise that oversees the work and decisions of the enterprise manager. See James L. Tyson, Chinese Conservatives Reverse Factory Reforms, Christian Science Monitor, Nov. 20, 1991, at 6.

50. State Enterprise Law, supra note 37, arts. 55-58.

plans to its subordinate enterprises. It also provides guidance and consultation services to the enterprises to help them in the formulation of policies. The government department may not encroach upon the property rights of the enterprises nor upon the independent operating rights of the enterprises; nor may it arbitrarily divert factors of production from one enterprise to another or arbitrarily fix the number of workers assigned to an enterprise.

Chapter seven, on legal liability, prohibits the unregistered operation of a state enterprise, fraud on the registration authorities, and specifies punishments ranging from a warning of possible fines to revocation of business licenses.[51] Article 67, one of the supplementary provisions in chapter eight, states that the State Council shall formulate rules for implementation of the State Enterprise Law.[52] However, as of March 1992, comprehensive rules for implementation have yet to be promulgated by the Chinese Government.

The promulgation of the State Enterprise law also assisted with the implementation of the Enterprise Bankruptcy Law of the People's Republic of China.[53] Shortly after the Civil Law was adopted, China adopted the Bankruptcy Law, which provides that it shall be implemented on a trial basis on the day marking the end of the third month of implemetation of the State Enterprise Law.[54]

At first glance, the regulatory framework seems sufficient to provide some autonomy to state enterprises. Many of the technical provisions of the State Enterprise Law, for instance, are designed to give state enterprises more decision-making power. In addition, under the Bankruptcy Law state enterprises are afforded the status of profit-seeking entities which are independent of the state.[55] However, these laws and regulations have failed to bring about needed changes to the inefficient state enterprises.[56] In particular, state enterprise representatives have recently complained that "the rights granted to

51. State Enterprise Law, supra note 37, arts. 59-64.

52. State Enterprise Law, supra note 37, art. 67.

53. The Enterprise Bankruptcy Law of the People's Republic of China, (adopted Dec. 2, 1986) [hereinafter the Bankruptcy Law], translated in 19 Vand. J. Transnat'l L. 733 (1986). See also Henry Zheng, Bankruptcy Law of the People's Republic of China: Principle, Procedure & Practice, 19 Vand. J. Transnat'l L. 683 (1986).

54. Bankruptcy Law, supra note 53, art. 43.

55. Bankruptcy Law, supra note 53.

56. One symptom of such failure is that most state enterprises are losing money and are billions of dollars in debt, see China Expands Capitalist-Style Enterprise Reform, supra note 7; China Searches for a Solution to Triangular Debt, supra note 7.

enterprises by the [State] Enterprise Law are largely withheld by governmental bodies at all levels."[57]

C. Policies Toward Separating Ownership from Operation

No examination of the reform measures for the regulation of Chinese enterprises can ignore the role of political influences and policy pronouncements. One obvious example is the legislative process surrounding the State Enterprise Law, in which the Communist Party played an important role throughout the drafting, redrafting and enactment of the Law.[58] Hence, the concept of operating rights must be understood in the context of its political-economic background.

One of the principal objectives of Chinese economic reform has been to seek ways to stimulate state enterprises that will, in turn, encourage economic growth. The Chinese have recognized that enterprises in a centrally planned economy lack initiative to boost productivity.[59] However, the benefits of giving greater autonomy to state enterprises cannot be fully realized as long as factory managers remain administratively responsible to their superiors in the relevant ministry of the state bureaucracy.[60] In the spirit of enterprise autonomy, the principle of separating ownership rights from operating rights has been established as the means to stimulate productivity.

Since most reform measures taken in the 1980s, including the measure to separate ownership and operation of the state enterprise, have achieved very limited success, policy-makers have recently begun to consider the need to make more fundamental changes. One of China's chief economic planners pointed out that changing enterprise operating mechanisms cannot simply be interpreted as the smashing of the "three

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57. Enterprise Association Urges Less Central Control, FBIS-China, May 1, 1992, at 25.

58. For instance, the Thirteenth Communist Party National Congress' "approval of the underlying principle of the separation of enterprise management from state ownership . . . sped up the legislative process and enabled the law to be passed within a few months." See Kenneth Wong & Zhonglan Huang, A Critical Analysis of the Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People, 7 UCLA Pac. Basin L. J. 180, 185 (1990).

59. A survey conducted by China's State Economic Commission in 1986 "confirmed that almost all large and medium-sized State enterprises 'showed few signs of vitality, due to a lack of decisionmakingpowers.' " Quoted in Julia S. Sensenbrenner, The Evolving Enterprise, China Bus. Rev., Mar.-Apr. 1987, at 35.

60. For a discussion of the state-enterprise relationship in the period prior to enactment of the State Enterprise Law, see Natalie Lichtenstein, Law and the Enterprise, China Bus. Rev., Mar.-Apr. 1987, at 38.

irons" — the iron ricebowl, ironclad wages, and the iron armchair (lifelong tenure); rather, changes must be integrated in an "organic" way with reforms in all areas to effectively bring about a shift in state enterprise operating mechanisms.[61] Echoing a similar policy line, an article in the *Renmin Ribao* declared that in 1992 China's economic structural reform will focus on "changing the enterprise operation mechanisms."[62]

In addition to creating favorable external conditions, the government has endeavored to improve the internal operational mechanism of state enterprises. Foremost among these measures are the reform of labor, personnel and wage distribution systems and establishing an incentive mechanism. To this end, more than one thousand state enterprises have been given capitalist-style management powers as part of sweeping efforts to reform the industrial sector. In addition, they have been given complete freedom in hiring and firing managers and workers, regulating wages and bonuses and determining their business policies.[63] In sum, "Governments . . . should not interfere in [enterprises'] internal concrete matters so that the enterprises can really be independent . . . and responsible for their profits and losses."[64] What is missing, however, is an effort to clarify the property relationship between the state and the state enterprise.

III. DECIPHERING THE STATE-ENTERPRISE PROPERTY RELATIONSHIP

The property relationship between the state and state enterprises arises because state enterprises, as productive units of the national economy, must utilize assets such as fixed assets (e.g., land and machinery) that are owned by the state. The challenge to the principle of "separating the two rights" is how to grant state enterprises maximum discretion to manage and use these state-owned properties while keeping the banner of state ownership intact. Against this background, the concept of operating rights has been created. This part of the article will

61. Chen Jinhua Urges Comprehensive Enterprise Reform, FBIS-China, Apr. 27, 1992, at 35 (quoting Chen Jinhua, minister in charge of the State Commission for Restructuring the Economy).

62. Deepen the Reform of Three Internal Institutions of Enterprises, FBIS-China, Apr. 16, 1992, (commenting on an article regarding the deepened reform of Shanghai's state enterprises).

63. See China Expands Capitalist-Style Enterprise Reform, supra note 7.

64. Ann Tyson, Chinese Leaders Push for Market-Based Reform in State-Run Industries, The Christian Science Monitor, Jan. 13, 1992, at 4.

consider the legal concept of, and theoretical debates on, enterprise operating rights.

A. *The Legal Concept of Enterprise Operating Rights*

As discussed above, the State Enterprise Law stipulated the rights and obligations of state-owned enterprises, the responsibilities of enterprise directors and workers and the relationship of the enterprise with the government.[65] Specifically, article 2 of the Law created a new legal concept — operating rights — which was intended to grant autonomy to state enterprises, with minimum interference from the government.[66] The second paragraph of article 2 states that the property of an enterprise shall belong to all the people and shall be managed by the enterprise with the authorization of the state, in accordance with the principle of separating ownership rights and operating rights.[67] Article 2 clearly indicates that operating rights are distinct from ownership rights;[68] however, the nature and scope of such rights are unclear. Article 2 further provides that an enterprise shall enjoy the right "to possess, use and legally dispose of property which the state has authorized it to operate and manage."[69] Although this definition of operating rights seems fairly specific and clearly defined, its scope is quite similar to that of ownership rights.

In accordance with article 71 of the Civil Law, ownership rights are defined as rights to "possess, use, benefit from, and dispose of" one's property.[70] A closer comparison of article 2 of the State Enterprise Law and article 71 of the Civil Law will show that ownership rights and operating rights share three constituent powers: possession, use and disposition. To inquire into the nature and extent of operating rights, it is necessary to consider first how the State Enterprise Law has laid out the regulatory scheme governing each of these constituent powers.

65. See supra notes 37-56 and accompanying text.
66. State Enterprise Law, supra note 37, art. 2.
67. State Enterprise Law, supra note 37, art. 2(2).
68. State Enterprise Law, supra note 37, art. 2(2). Article 2(2) reads, "An enterprise's assets belong to the whole people. The state follows the principle of separating an enterprise's ownership from its management rights. . . ." State Enterprise Law, supra note 37, art. 2(2).
69. State Enterprise Law, supra note 37, art. 2.
70. Civil Law, supra note 21, art. 71.

(1) *The right of possession.* In order to perform productive functions, state enterprises have to take possession of state-owned properties such as land and machinery. Although the need for possession rights is quite apparent, it has previously caused significant difficulty. In the past, a major problem confronting a typical state enterprise would be that various governmental entities at different levels (e.g., local, provincial and national) and other state enterprises would frequently impose upon the state enterprise to "apportion" (*tanpai*) materials or financial resources to them. This imposition was accomplished through political pressure, connections and interests groups. To prevent such illegal allocations, the State Enterprise Law provides that an enterprise shall have the right "to refuse the apportionment of its labor force, material resources or financial resources by any administrative organ or unit."[71] A reasonable reading of this language compels the conclusion that the state enterprise does possess rights which can be asserted against other parties. However, the second part of this provision reads: "Except if the law or statutory regulations prescribe otherwise, any demand made on an enterprise to provide . . . resources shall be deemed to be apportionment by force."[72] Pursuant to this language, the state could apportion resources if the law prescribed such apportionment. Under these circumstances, a state enterprise would not be entitled to assert possession rights against the state.

(2) *The right of use.* The right to use various enterprise assets (including fixed assets or production materials) is clearly the heart of the production function of any state enterprise. In the past, the state determined the kind and quantity of products an enterprise could produce as well as selected the suppliers and arranged for the supplies needed by the enterprise. Under the State Enterprise Law, the mandatory plan imposed upon an enterprise is now more flexible than previously prescribed, and the enterprise has much more freedom in carrying out its production activities. For instance, a state enterprise has the right to request an adjustment in the directives covering the supply of materials and the arrangement of product sales.[73] In addition, an enterprise is entitled to sell goods independently if they are produced in excess of the planned quota or are retained by the enterprise as its share

71. State Enterprise Law, supra note 37, art. 33.
72. State Enterprise Law, supra note 37, art. 33.
73. State Enterprise Law, supra note 37, art. 23.

under the plan.[74] Yet, despite the advances spurred by the State Enterprise Law, it is fair to say that even under the more liberalized State Enterprise Law, the right of use is still subject to some significant restrictions.

(3) *The right of disposition.* Two scholars argue that the right of disposition includes both disposition in fact and disposition in law.[75] Disposition in fact means the process whereby producers utilize input materials to produce output; and as a result of disposition in fact, the value of input materials disappears and the value of output products is created.[76] In contrast, disposition in law means the process whereby state enterprises transfer the properties to others.[77] An example is when a state enterprise sells its products to others by entering into sales contracts.[78] Article 24: "An enterprise shall have the right to sell its own products, unless State Council regulations prescribe otherwise."[79] The second paragraph of this article further provides that, "An enterprise undertaking production in accordance with a mandatory plan shall be entitled to sell by itself those products in excess of the planned quota and those products which it retains as its share under the plan."[80] Under the State Enterprise Law, state enterprises appear to have the right of disposition over their products; however, this right is also subject to the relevant laws and regulations.

Although ownership rights and operating rights share three constituent powers, they are different in one major aspect. Unlike ownership rights, operating rights do not include the right to benefit (*shouyiquan*). Is the right of benefit a right distinct and separate from other rights such as possession, use and disposition? If it is, does it follow that the holder of operating rights does not have the right to enjoy the fruit of its operation? In many jurisdictions, the exclusive powers of possession, use and disposition would constitute a sensible

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74. State Enterprise Law, supra note 37, art. 24.
75. Cao & Zhang, infra note 78, at 65.
76. Id.
77. Id.
78. See Cao Kang & Zhang Ling, Liangquan Fenli Yu Chengbaozhi de Fansi yu Shexiang [Reconsidering the Principle of Separating Two Rights and the Responsibility Contract System] Zhongguo Faxue 5 [China Jurisprudence] 61, 65 (1990).
79. State Enterprise Law, supra note 37, art. 24.
80. State Enterprise Law, supra note 37, art. 24.

configuration of property rights. In the United States, for example, "[p]roperty rights in a physical thing have been described as the rights 'to possess, use and dispose of it.' "[81] In civil law countries such as Germany, from which the Chinese have borrowed legislative experience, ownership is defined as the right of "use, profit and disposition."[82] These two definitions on ownership, although different in wording, are very similar in scope. This is because if one has the right to use and dispose, it implies that one also has the right to the benefits or profits resulting from such use and disposition. Consequently, the fact that the right of benefit is specifically excluded from the operating rights of Chinese state enterprises has significant implications. By granting state enterprises the rights of possession, use and disposition but not the right of benefit, the state appears to have conveyed to state enterprises the right to endure and control costs on their own (labor, risk-taking, planning and transaction costs) but not the right to enjoy their own benefits.

Another statutory difference between ownership rights and operating rights is the qualifying language they are subject to. In the case of operating rights the word "legally" is placed immediately before the words "to dispose of property,"[83] while in the case of ownership rights the word "legally" is used to modify all the constituent powers of ownership (rights of possession, use, benefit and disposition).[84] As will be demonstrated below, only the word "legally" applicable to operating rights imposes real constraints on dispositions.[85]

At first glance, the concept of operating rights appears to be clearly defined and fairly specific. However, after a closer inspection of the statutory language, one finds that the concept abounds with ambiguities. For example, there are puzzling similarities and differences between ownership rights and operating rights. Deciding which theory should be used to define the nature of operating rights, therefore, becomes a very challenging exercise. In China, legal scholars have come up with over a dozen theories to explain the nature of operating rights.[86] These scholars appear to have similar goals in mind: to give economic

81. Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 435 (1982) (quoting United States v. General Motors Corp., 323 U.S. 373, 378 (1945).
82. The German Civil Code (amended as of Jan. 1975) 145 (Forrester trans.).
83. State Enterprise Law, supra note 37, art. 2.
84. Civil Law, supra note 21, art. 71.
85. See infra notes 160-169 and accompanying text.
86. See Epstein, supra note 22, at 197.

autonomy to state enterprises, thereby enabling them to use state-owned property efficiently.

B. Differing Theories on the Nature of Operating Rights

The nature of what comprises operating rights remains a source of controversy. Based on the statutory framework discussed above, operating rights might fall into any one of three categories: agency relationship, contractual rights and rights in things.[87] In addition to the above categories, some theorists have argued that operating rights fall into a fourth category of specially created rights with Chinese characteristics;[88] in other words, they are rights *sui generis*. The following analysis will discuss these four theories advocated by representative scholars.

It should be noted that the analysis of differing theories is not intended to be an exhaustive treatment of all the theories that have been advanced;[89] rather, it is intended to demonstrate, by way of example, how legal theories in China have struggled to come up with a working theoretical model. It is hoped that such an examination will illuminate the current thinking[90] of Chinese legal theorists and thereby provide perspectives on the understanding of operating rights.

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87. See supra notes 18-57 and accompanying text. The representative categories used here are consistent with the continental civil law system and China's legal framework in the Civil Law. Rather than study all the theories (e.g, possession, usufruct), this article considers the broader categories in a more systematic manner.

88. See Zhang, infra note 118.

89. In surveying more than thirty Chinese theoretical discussions on property rights in the state enterprises, one legal scholar identified approximately ten different schools of thought. See E. Epstein, supra note 22. As the debate has intensified since the promulgation of State Enterprise Law, commentators have come forward with even more theories. See infra notes 65-73 and accompanying text.

90. The controversy over management rights has proceeded for over a decade. It can be divided into two periods: (1) the pre-1988 period, where theorists relied upon general legal principles and the Civil Law as their basis; and (2) the post-1988 period, where both the Civil Law and the State Enterprise Law were used as sources for articulating theories. This article focuses on the post-1988 period. For a discussion of the legislative history and theoretical debate in the pre-1988 period, see Epstein, supra note 22.

1. Agency Relationship

Pursuant to agency theory, a state enterprise is merely an agent authorized by the state to manage specific properties. For instance, one legal theorist argues that operating rights contemplate some kind of agency relationship.[91] Citing statutory support from the State Enterprise Law, Li Zhuguo first points out that operating rights should not be considered as rights in things because state enterprises are not allowed to enjoy the profits of management.[92] Although the State Enterprise Law provides that state enterprises have the right to use "retained funds" according to State Council regulations,[93] it is by no means a right to benefit. Li argues that the Law indicates that state enterprises are allowed to have some discretion over such funds, but the state, as the owner, still determines the amount of such funds and the acceptable range of enterprise discretion.[94] In other words, state enterprises do not have the right to use and dispose of profits at their will; rather, they must follow the instructions of the state.[95] Li therefore concludes that, because state enterprises are always required to take orders from the government, the state-enterprise relationship should be considered as one of agency.[96] However, even an agency theory proponent such as Li admits that the theory is less than ideal. He notes that the state-enterprise relationship can only be categorized as a quasi-agency relationship.[97] Since theoretically state-owned property is owned by "the whole people," enterprise managers (as members of society) assume double

91. See Li Zhuguo, Quanming Qiye Jingying Quan Xingshi Qiantan [A Preliminary Inquiry on the Nature of State Enterprise Operating Rights], 2 Zhongguo Faxue [China Jurisprudence] 63 (1989).

92. Id.

93. State Enterprise Law, supra note 37, art. 28.

94. Li Zhuguo, supra note 91, at 63. It should be noted that the wording was changed from "its capital" to "retained capital" during the last revision of the draft Law. See Wang Baoshu, supra note 38, at 5. An English version of article 28 (in the earlier draft article 26) read: "An Enterprise has the legal right to control the use of its capital according to the State Council's regulations."

95. Thus, Li's argument is based on the premise that a right in things must include the constituent power to benefits and profits. How this could be the case remains unclear. In many Continental civil law jurisdictions, a right in things (e.g., right to possession) does not necessarily include the power to profit element.

96. Li Zhuguo, supra note 91, at 63-64.

97. Id. at 64-65.

capacities — both as agents and co-owners — with respect to state property under their management.[98]

Another similar agency theory is advocated by Hu Qu. He argues that since the state and the state enterprise are not equal parties, their relationship should not be governed by the Civil Law system.[99] Consequently, the operating rights of state enterprises should be regarded as responsibilities rather than rights because state enterprises have no right to refuse the operating rights conferred by the state.[100]

The agency theory is inconsistent with the statutory language of the Civil Law. By definition, an agent is a person who by mutual assent acts on behalf of, and subject to the control of, another. Under article 48 of the Civil Law, a state enterprise bears civil liability to the extent of the property that the state has given it to operate and manage.[101] Consequently, a state enterprise itself, rather than the state, should take responsibility for the use of properties owned by the state. On a more practical level, if the agency theory is adhered to, the purpose of operating rights — to afford maximum autonomy to state enterprise — would be frustrated.

2. Contractual Rights

This theory holds that management rights are contractual rights. According to the theory, although the state is the owner of property, it cannot directly manage all state property. Based on its own interests and needs, the state gives specific property to state enterprises to manage and operate. This type of relationship can be regarded as either a trust arrangement[102] or a contractual arrangement such as responsibility-based contract system. Under a responsibility-based contract system, the state contracts with the enterprise to undertake a series of economic and technical goals such as profit targets and equipment utilization rates.[103]

98. Id. at 65.

99. Hu, infra note 100.

100. Hu Qu, Lun Woguo Gongsi Lifa de Zhangai [On the Obstacles of Our Country's Corporate Legislation], 67 Faxue Yanjiu [Legal Studies] 62, 64 (1990).

101. Civil Law, supra note 21, art. 48.

102. See Jin Ping & Zhao Yongshan, Guojia Caichan Quan yu Weituo Jingying Quan [The State's Property Rights and the Right to Entrust Operating Rights], 4 Zhongguo Faxue [China Jurisprudence] 32 (1985). This theory must be read with the understanding that China has yet to develop a trust law system.

103. Wang & Liu, supra note 32, at 37-41.

Li Zhuguo refutes the theory that operating rights can be considered as contractual rights.[104] He notes that the state-enterprise property arrangement is not a "commodity exchange relation"; instead, it is a system whereby responsibility is distributed through an administrative system.[105] Pursuant to this arrangement, the state sets goals for the state enterprise to achieve. It follows that this arrangement does not contemplate any transfer of property rights between the state and the enterprise; therefore, Li argues, operating rights should not be considered as contractual rights.[106]

The contract theory, like the agency theory, can be found to have inadequacies. Arrangements such as a responsibility-based contract system should not be regarded as contractual arrangements at all. A real contractual relationship presupposes an equal civil relationship and equal bargaining power between the state and the enterprise; whereas in the case of a responsibility contract system, the state dictates the terms of the relationship.[107] In addition, under a responsibility contract system the state can supply terms as it sees fit and can subject an enterprise's operating rights to open-ended modifications. Consequently, the goal of enterprise autonomy cannot be realized under this theory.[108]

3. Rights in Things

Tong Rou, an eminent legal theorist and one of the co-drafters of China's Civil Law, takes the position that operating rights are (a type of) independent real rights or rights over things.[109] As such, the holder of the rights can, based on law, resist any person, including the owner (i.e., the state).[110] Tong also argues that operating rights are neither a single attribute of ownership nor a form of relative ownership; they are rights in things which give enterprises exclusive control over the

104. Li Zhuguo, supra note 91, at 63.

105. Li Zhuguo, supra note 91, at 63-64.

106. See Li Zhuguo, supra note 91, at 63-65.

107. For a discussion of the shortcomings of the responsibility contract system, see Cao Kang & Zhang Ling, supra note 78, at 61-66.

108. It was pointed out that the ambiguous legal relationship of responsibility contract system needs to be disentangled. Liao Yanbao, Sanzi Qiye Zulin Jingying he Chengbao Jingying Falu Xingzhi Chutan [An Inquiry into the Nature of Lease and Responsibility Contract System of Foreign-Invested Enterprises], 6 Zhongguo Faxue [China Jurisprudence] 90 (1989).

109. Tong Rou, The General Principles of Civil Law of the PRC: Its Birth, Characteristics, and Role, 52 Law and Contemp. Prob. 151, 172 (Jonathan K. Ocko trans., 1989).

110. Id.

property they operate.[111] Therefore, once state property has been transferred to an enterprise it cannot be acquired or reallocated by the state without compensation.[112]

Tong's views have been accepted by some scholars in China. For example, in discussing the system of rights in things, Jiang Shan argues that state enterprise operating rights are a new type of rights in things.[113] He points out that operating rights stipulated in article 82 of Civil Law are typical rights in things.[114] This is because operating rights possess all the distinctive features of rights in things. First, operating rights are rights of dominion, whereby state enterprises are entitled to dispose of property granted by the state under law. Second, such rights exist in specific and independent properties and thus no one else can interfere with the use of such properties. Third, the content of operating rights is to directly possess, use, profit and dispose of properties granted by the state. Fourth, since operating rights are rights to exclude, no other rights inconsistent with the nature of such rights can be created over operating rights. Fifth, operating rights are derived from the ownership rights of the state, but are property rights separate from ownership rights.[115]

Jiang's position represents a more elaborate effort to give operating rights status as a special right in things. In contrast, some scholars previously attempted to explain operating rights in terms of other traditional rights in things (e.g., possession rights or usufruct) adopted in Continental civil law systems.[116] However, such attempts are fraught with theoretical difficulties. For instance, usufruct does not usually entitle the usufructuary to dispose of the subject matter, an essential attribute of the statutory powers of a state enterprise.

The theory that categorizes operating rights as a right in things, if adopted, might achieve the purpose of attaining enterprise autonomy because it would enable state enterprises to use and dispose of state

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111. Id.

112. Tong & Zhou, Lun Guoying Qiye Jingying Quan [A Discussion of the Operating Rights of State Enterprise], 3 Faxue Yanjiu [Legal Studies] 12, 17 (1986).

113. Jiang Shan, Shilun Wuquan he Woguode Wuquan Zhidu Tixi [On Rights over Things and Our Country's System of Rights over Things], 5 Faxue Yanjiu [Legal Studies] 70, 73-74 (1988).

114. Thus, Jiang's position is that although the Civil Law does not explicitly provide for rights in things, the ownership and property rights related to ownership stipulated in article 82 are in essence rights in things. Id. at 73; Civil Law, supra note 21, art. 82.

115. Jiang Shan, supra note 113, at 73.

116. Wang & Liu, supra note 32, at 30-31.

property with minimum interference from the state. However, the current statutory framework does not provide state enterprises with a mechanism through which they can enforce such rights when they are infringed upon by third parties, including the state.

4. Rights *Sui Generis*

Given the difficulties in developing a satisfactory theory on the essence of operating rights, one possible way to confront this issue is to argue that operating rights are rights *sui generis*. For example, Zhang Ling argues that operating rights are rights *sui generis* granted to state enterprises.[117] Zhang applies Marxist theory in reviewing the history of economic development and property rights in China and concludes that the creation of operating rights is a "natural outcome" of historical evolution.[118] Although she provides justifications for the principle of "separating the two rights," she neither defines the nature and extent of operating rights nor explains why they are rights *sui generis*.[119]

C. *Summary*

Each theory proffered as an explanation of enterprise operating rights is marked by shortcomings that symbolize the puzzling nature of these rights. None of the theories can satisfactorily explain the nature and extent of operating rights. Some, such as agency, fail because they frustrate the purpose of operating rights — allowing state enterprises greater autonomy in managing state-owned properties. Other theories (e.g., rights *sui generis*), while innovative, lack substance. The rights in things approach appears adequate but lacks sufficient support in the

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117. Zhang Ling, Jingying Quan Chanshen Genju Xingtan [A New Inquiry Into the Basis of Management Rights], 6 Faxue Yanjiu [Legal Studies] 47 (1988). However, in a subsequent article on the relationship between separating the two rights and the responsibility contract system co-authored by Zhang Ling, the authors argued that state enterprises should enjoy operating rights which include "full" rights of possession, use and disposition. See Cao & Zhang, supra note 78, at 66.

118. Zhang, supra note 117, at 49-50.

119. Id. at 47.

statutory language considered earlier.[120] Thus, the question persists: what kind of "lawful rights and interests"[121] do operating rights entail?

IV. THE PROBLEM WITH ENTERPRISE OPERATING RIGHTS

A pragmatic response to the criticism of theories mentioned above might be that, despite the lack of a solid theoretical foundation, current operating rights as defined in the State Enterprise Law are in fact working in balancing the state-enterprise property relationship. To counter this pragmatic rhetoric, it is necessary to consider how the current operating rights have worked in practice.

A. *The Personhood of State Enterprises*

The increasing independence of enterprises as separate economic units under the economic reforms has been reflected in their status as legal persons (*faren*) under Chinese Law. The new legal status of enterprises marks a departure from the reluctance of the Chinese government in the pre-reform period to provide them with meaningful independence.

Chapter three of the Civil Law deals specifically with legal persons.[122] Among the four categories of legal persons defined therein, the category of enterprise legal persons occupies the most prominent and

120. As articles 80 to 83 of the Civil Law demonstrate, the five constituent powers of ownership can be distilled from ownership individually or in combination. These ownership rights have the appearance of being rights in things, which would lead one to believe that any of the legally defined derivative rights, including operating rights, are recognized as independent property rights. As an example, one might argue that a violation of operating rights by a third party would be sufficient to support an action by the holder of such rights (i.e., state enterprises) to seek reversion of the underlying property or to claim damages. However, it is not at all clear under current Chinese law whether and how a state enterprise could accomplish these remedies, especially in cases when the state itself is the suspect of the violation. If the state-owner decides to take back a state-owned property from a state enterprise, the enterprise would probably not be able to assert any operating rights against the state. Since the state enterprise would not have any claim or recourse against the state, it would have no alternative but to comply.

121. Articles 14 and 15 of the State Enterprise Law provide that property which the state authorizes an enterprise to manage, as well as the "lawful rights and interests" of enterprises, shall receive the protection of the law and shall not be infringed upon. State Enterprise Law, supra note 37, arts. 14-15.

122. Under this chapter, legal persons are defined as "organizations that have civil capacity, are competent to perform civil acts, and according to law independently enjoy civil rights and assume civil duties." Civil Law, supra note 21, arts. 36-50.

important position.[123] Through chapter three, the Civil Law gives official sanction to the "legal person" and enables enterprises to claim that the law permits them to possess individual status and to engage in activities as entities separate from supervising high level ministries.[124] In addition, article 2 of the State Enterprise Law also makes clear that state enterprises are legal persons under the Civil Law, with the same status and ability to undertake obligations as all legal persons.[125]

It should be noted, however, that the designation of "personhood" to a state enterprise is a matter of convenience only. The fact that a state enterprise can be described as an independent legal person does not mean that it "has autonomy in management and takes full responsibility for its profits and losses."[126] In determining whether a state enterprise possesses these distinctive features, other criteria (e.g., whether it has independent assets, unlimited liability or its shareholders are residual claimants) are more important. As in the case of analyzing other areas of law, when examining the rights of a state enterprise what is important is substance, not form. What follows is a review of operating rights in practice, designed to see how operating rights bear on, or figure into, the state enterprise as an independent economic entity or legal person.

B. *The Costs of Operating Rights in Practice*

It is fair to say that the reform of state enterprises in China is in disarray. Although numerous reasons can be offered as explanations for the disorder, the ambiguity surrounding the state-enterprise property relationship is perhaps the most significant reason. As a legal concept, operating rights not only lack a solid theoretical foundation but also have encountered many problems in practice. The problems are threefold: autonomy, incentives and accountability.

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123. The other categories are government agencies legal persons, institutions legal persons, and association legal persons. Civil Law, supra note 21, art. 41. The PRC Regulations on the Administration of Enterprise Legal person Regulation, effective on July 1, 1988, provides a mechanism for the registration of enterprise legal person. For a discussion of the status of legal persons in China, see Zhao Zhongfu, Enterprise Legal Persons: Their Important Status in Chinese Civil Law, 52 Law & Contemp. Probs. 1 (Winston J.S. Zhao trans., 1989).

124. Civil Law, supra note 21, art. 41.

125. State Enterprise Law, supra note 37, art. 2.

126. State Enterprise Law, supra note 37, art. 2.

1. Autonomy

The problem of autonomy is the most pressing. Although state enterprises are equipped with operating rights, the central government still exercises extensive control over state enterprises in many ways, thereby restricting autonomy. Chief among them is that the state, as the owner and contributor of state-owned assets, can exercise ownership control over assets managed by the enterprise. The problem is aggravated by the possible control exercised by regional governmental entities.[127] The actions taken by the central government are sometimes constrained or contradicted by ownership rights asserted by various organizations that occupy an intermediate position in the hierarchicay between the central government and state enterprises.[128] The multilevel supervision exercised at different levels of government has caused conflicting targets and discipline problems.[129]

The direct exercise of ownership rights by state organs over the property managed by state enterprises mixes the property rights and administrative relations between the state entities and the enterprises. As state and enterprise become more indistinguishable, administrative methods interfere with the production activities of the enterprises. This results in the rigidity of socio-economic activities and impedes the vitality of enterprises. For instance, as the owner of state-owned assets, the state can reallocate the assets to another enterprise without compensation. This reallocation is considered an administrative decision and, therefore, not subject to the rules of the Civil Law.[130] In contemplation of the possibility of such an action, an enterprise's management might be reluctant to expend enterprise resources for

127. In contrast to other socialist countries, Chinese state enterprises usually fall under the higher authority of more than one government entity. This is due to the fact that property rights are sometimes shared by regional governments. See David Granick, Chinese State Enterprises: A Regional Property Rights Analysis 20-70 (1990); It has been reported that of all state-owned assets, institutions affiliated with the central government account for only 49.2 percent, or about $215.12 billion (U.S.). State-Owned Assets Valued at $436.8 Billion, supra note 6, at 40.

128. Governments at the provincial and municipal levels can exercise ownership power over state enterprises not only because the central government decides, as a matter of administrative efficiency, to delegate certain powers to them, but also because the central government, in fact, recognizes regional governmental claims to this power. Governments at the regional level obtain ownership rights in state enterprises by one of two means: (1) through investment in the fixed capital of the state enterprise or (2) through historical tradition. Granick, supra note 127, at 20-70

129. Donald C. Clarke, Regulation and its Discontents: Understanding Economic Law in China, 28 Stan. J. Int'l L. 290-94 (1992).

130. Civil Law, supra note 21.

maintaining capital equipment and making long-term production plans.[131] Consequently, although an enterprise would have operating rights over fixed assets, it would still be discouraged from making long-term investment and improving fixed assets.[132]

The costs incurred to control fungible assets such as machinery and equipment are even greater than that of land. As the owner of such assets, the government must exercise control to prevent conversion of such assets into current assets. Article 29 of the State Enterprise Law provides that any income received from the lease or assignment of fixed assets shall be used to renovate facilities and upgrade technology.[133] Such restrictions on the use of income not only impede the efficient use of resources,[134] but also create substantial monitoring costs. In order to prevent illegal conversions and misappropriation of proceeds, it is necessary for the government to trace the identifiable proceeds received from any disposition of assets. Even if managers in state enterprises are required to deposit the proceeds of sales into segregated accounts, in practice, they may well break this rule by commingling the proceeds with other funds.[135]

2. Incentives

The lack of market incentives is also a problem which can be solved by redefining operating rights. Pursuant to article 2 of the State Enterprise Law, each enterprise "takes full responsibility for its profits and losses and practices independent business accounting."[136] It follows that an enterprise's ultimate responsibility for its own profits and losses will cause its managers to be more concerned about efficiency and profits. One would surmise that, a state enterprise, as a holder of operating rights, would allow itself and its managers to benefit from the fruit of good management. However, although the State Enterprise Law provides that a state enterprise has the right to allocate and use its

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131. See Perkins, supra note 3, at 162.

132. Recall that the common characteristic of fixed assets (i.e. land and machinery) is that recoupment, typically use, will occur over a period of years, perhaps extending over the life span of the state enterprise.

133. State Enterprise Law, supra note 37, art. 29.

134. Clarke, supra note 130, at 319.

135. For a discussion of the problems of "tracing" in the context of secured transactions, see, e.g., Ray D. Henson, Handbook on Secured Transactions Under the Uniform Commercial Code 195-210 (1979).

136. State Enterprise Law, supra note 37, art. 2.

retained funds according to State Council regulations,[137] it by no means contemplates a full-fledged right of profits. The Law only says that state enterprises are allowed to have some discretion over retained funds in accordance with regulations.[138] The state, as the owner, still decides the amount, if any, of such funds and the acceptable range of enterprise discretion.[139] As a result, state enterprises still might not be sufficiently motivated by this compensation scheme and, at times, might revert to the inefficient security of the iron rice bowl.

3. Accountability

The third problem of operating rights in practice concerns accountability. State enterprises need to know that their survival and profitability depend on their own actions and decisions rather than on governmental discretion and informal support. An important task in the era of economic reform has been to develop a sense of budgetary constraints within enterprises, making enterprises and government sensitive to the difference between costs and revenues. Fostering this sensitivity has been impeded by several factors. For instance, there is the problem of understanding the concept of profit. Due to the large discrepancies between accounting prices and market prices, however, "accounting profits provide a poor approximation of true economic profits."[140] As a result, when making allocation decisions, the government cannot rely on the information available in a firm's financial accounts to judge the merit of any given project.[141] It was also reported that much of the rise in output has been fuelled by a bank lending spree that was intended to lift output to a level that would allow the central government to argue that state plan targets had been met.[142]

Accountability requires a reasonably adequate bankruptcy law to be in place and, more importantly, a willingness to use this law to force reorganization or even liquidation. One example illustrates this point

137. State Enterprise Law, supra note 37, art. 28.

138. State Enterprise Law, supra note 37, art. 28.

139. It should be noted that the wording in article 28 was changed from "its own funds" to "its retained funds" during the last revision of the draft Law. State Enterprise Law, supra note 37, art. 28. See supra notes 91-94 and accompanying text.

140. Gordon & Li, supra note 3, at 203.

141. Id. at 204.

142. David Dodwell, Central Planners Who Cannot Let Go - State Industries Losses Spiral Out of Control, Financial Times, Apr. 24, 1991, at 4.

succinctly. "Despite the increasingly serious situation and a new bankruptcy law enacted in 1988,[143] not one of China's state firms ha[s] ever been declared officially bankrupt."[144] One reason for such vacillation is that it is unclear whether creditors are permitted to foreclose state-owned properties managed by the bankrupt enterprise.

In short, the jumbled property relationship between the state and state enterprises has contributed to the inefficiency of state enterprises. Specifically, current operating rights as defined in the State Enterprise Law have not enabled enterprises to make socially productive use of state-owned assets such as fixed-assets and land. Since state enterprises do not operate under a system of economic autonomy and market incentives, society as a whole bears the economic burden of inefficient enterprise behavior. The core of the problem (and the solution) lies in making "some fundamental changes in property rights."[145]

C. Possible Solutions

Given the serious costs of the current operating rights system, it is not surprising that China's policy-makers and theorists have considered various measures to reform state enterprises. Although some argue that a successful reform calls for drastic measures such as property rights reform, others believe that moderate reforms within the existing socio-economic regulatory framework will be sufficient. This article will examine below two approaches endorsed by many scholars.

1. Responsibility Contract System

It might be argued that the flexible nature of operating rights affords the opportunity to try out new systems or arrangements whereby an optimal state-enterprise cooperative relationship might be achieved. One such arrangement contemplated by the State Enterprise Law is the so-called responsibility contract system. The fourth paragraph of article 2 provides that an enterprise may adopt such forms of operational

143. See supra note 53.

144. Chinese Economists Urge State to Let Firms Go Bankrupt, The Reuter Library Report, Aug. 11, 1991, available in LEXIS, Nexis library, LBY RPT file (quoting The Official China Daily, Aug. 11, 1991).

145. G. White, Chinese Economic Reform: Is it Enough?, L.A. Times, Feb. 11, 1991, at D3 (quoting Ramon Myers on China's state enterprises).

responsibility as contracting or leasing.[146] Of these two arrangements, the responsibility contract system has been used more frequently by state enterprises.

Although a responsibility contract system can take many forms, it usually involves a contract entered into between the supervising governmental agency and a state enterprise.[147] The contract will stipulate major terms such as the power of the state to appoint managers and to specify profits for the contracting enterprise. This system, however, has failed to improve the efficiency of state enterprises. For instance, it has been criticized as causing a short-term mentality and over-investment in state enterprises.[148]

In essence, a responsibility contract system is an administrative contract between the state and a state enterprise, with the state dictating its terms. It is clear that under this system the state owns the assets managed by the state enterprise, but it is still unclear what kind of operating rights a state enterprise has over such assets. Hence, this does not offer a solution to the problem caused by operating rights; it simply contracts around the heart of the problem — the entangled state-enterprise property relationship.

2. Equity Stock Enterprises

In seeking to clarify the state-enterprise property relationship, Chinese theorists have at times tried to draw analogies and lessons from Western-type corporations. A classic debate involves the feasibility and practicality of establishing equity stock corporations in China.

The Guo Feng-Wang Liming debate illustrates the mystification over the equity stock corporations. In an article published shortly after the promulgation of the State Enterprise Law, Guo Feng discusses the developments of Western corporations and China's state enterprises.[149] He concludes that, in order to establish equity stock enterprises in China, it is essential for the state to transfer state-owned assets to the state enterprises and then to become stockholders of those enterprises.[150] Wang Liming disagrees. He argues that state ownership

146. State Enterprise Law, supra note 37, art. 2.

147. Kang & Ling, supra note 78, at 62-64.

148. Id. at 62.

149. Guo Feng, Gufenzhi Qiye Soyouquan Wenti de Tantao [An Inquiry into the Ownership Issue of Equity Stock Enterprises] 3 Zhongguo Faxue [China Jurisprudence] 3 (1988).

150. Id. at 9-10.

would neither impede the establishment of equity stock enterprises nor interfere with enterprise autonomy.[151]

More recently, Yuan Jianguo criticized the view that once equity stock corporations are established, the property rights problem can be resolved spontaneously.[152] Since the "ambiguous property right system" is a unique Chinese experience, it is doubtful that the idea of Western style corporations would work in China.[153] He therefore concluded that a precondition to equity stock corporations is the clarification of the property rights issue.[154] In addition, Song Yanni takes a more conservative view about the feasibility of establishing equity stock corporations. While criticizing the "speculative" nature of Western-style corporations, Song admits that under the current state-owned system it would not be feasible to create "single shareholder corporations."[155] Despite the doubts of some legal theorists, the idea of equity stock corporations is still very popular.

The controversy over equity stock enterprises demonstrates how some Chinese theorists have confused conceptions of property rights, organizational forms and administrative control. In contemplating Western-style equity stock enterprises, some Chinese theorists have ignored key differences between Western corporations and Chinese state enterprises. A typical Western corporation is characterized by a statement of capital contributions as formal claims against the firm's income that are distinct from participation in the firm's activities. The corporation issues stock in exchange for an investment, and investors bear the risk of failure and receive the marginal rewards of success.[156] What is essential in a corporate setting, therefore, is a pool of corporate assets which, until the residual claims of investors are exercised, belong to the corporation and are segregated from its owners. Consequently, if a state enterprise does not own the major productive assets (i.e., fixed

151. Wang Liming, Lun Gufenzhi Qiye Suoyouquan de Erchong Jiegou: Yu Guo Feng Tongzhi Shangque [On the Double Structure of Stock Enterprise Ownership: An Enjoinder to Comrade Guo Feng], 1 Zhongguo Faxue [China Jurisprudence] 47 (1989).

152. Yuan Jianguo, Woguo Gufenzhi ji Gufenzhi Lifa [Our Country's Stock System and its Legislation], 1 Zhongguo Faxue [China Jurisprudence] 53, 57 (1991).

153. Id. at 57-58.

154. Id. at 59.

155. Song Yanni, Woguo Gongsi Lifa Chutan [A Preliminary Inquiry into Our Country's Corporate Legislation], 5 Zhongguo Faxue [China Jurisprudence] 68, 70 (1991).

156. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 1-15 (1991).

assets or land) or cannot accurately state its assets and liabilities, there is no point in trying to convert it into an equity stock corporation.

More importantly, the original drive towards the corporate form is to make sure that each participant (or the only participant) in the entity is not an owner of each individual asset held by the corporation. By placing the corporate veil between the assets and the investor(s), the transfer and disposition of assets is done far more easily by the firm.[157] In addition, by aggregating all the assets under its management, the corporation as an independent economic entity can pursue profits in an efficient way. In other words, the imposition of a separate legal layer is another way to ensure enterprise autonomy.[158]

In conclusion, until the nature and extent of enterprise operating rights are fully clarified, any attempts to convert state enterprises into equity stock corporations will be doomed to failure.[159] This leads back to the primary question: what kind of rights does a state enterprise hold over the state-owned properties which are under its management?

V. THE CASE FOR REDEFINING ENTERPRISE OPERATING RIGHTS

A. *The Concept of Property Rights Revisited*

While this is not the place for an extended digression into the theories[160] (or critical theories)[161] of property rights, it is worthwhile to mention briefly the distinctive features and justifications for

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157. Similarly, at the shareholder level the assignment of interests is facilitated because each share is fungible with all other interests, without a detailed examination of the status of the title for each particular asset. For a discussion of the theory of organizations, see, e.g., Oliver Hart, An Economist's Perspective on the Theory of the Firm, 89 Colum. L. Rev. 1757 (1989). The multiple stockholders issue is irrelevant as long as the state is the sole representative owner of state properties.

158. The imposition of a separate legal layer, of course, creates the explicit governance question, which is beyond the scope of this article.

159. For instance, a 1989 survey of ninety-seven equity stock corporations that have been converted from medium/small collective or state enterprises shows their performance fell widely short of expectations. For an empirical study on this survey, see Yuan, supra note 152, at 53.

160. For instance, property rights are regarded in classical liberal thought as sources of stability and security that foster individual autonomy and protect the owner against the vicissitudes of life.

161. In the United States, scholars from the Critical Legal Studies camp seek to enhance individual freedom and economic decentralization by disaggregating property rights, freeing them from the liberal concept of property as "more or less absolute claims to divisible portions of social capital, claims that can be transmitted in unbroken temporal succession, including inheritance." Roberto M. Unger, The Critical Legal Studies Movement, 96 Harv. L. Rev. 563, 593 (1983).

establishing property rights. Such a discussion will provide meaningful perspectives on the nature and boundaries of China's enterprise operating rights.

Although many theories on property rights are in place,[162] for present purposes this article will only consider a utilitarian approach. Opponents of this theory might point out that it espouses a utilitarian perspective in the tradition of wealth-maximization, which arguably runs counter to socialist ideology.[163] However, in an effort to give autonomy to state enterprises, China intends to increase enterprise efficiency — which in itself is also a wealth-maximization goal. In addition, the utilitarian approach is justified because the subject matter of this article covers fixed assets only — assets which are held primarily for production or investment. As such, they are not bound up with the person, and hence would not bring up the complicated issue of property and personhood.[164]

According to Demsetz:

> [P]roperty rights derive their significance from the fact that they help a man form those expectations which he can reasonably hold in dealing with others. An owner or holder of property rights possess the consent of fellowmen to allow him to act in particular ways. A primary [economic] function of property rights is that of guiding incentives to achieve a greater internalization of externalities.[165]

In other words, property rights arise when it becomes economical for those affected by externalities to internalize costs and benefits.

As an economy becomes more sophisticated, it becomes possible to parcel out some of the elements of ownership rights and to create different categories of property rights. In most jurisdictions (including civil law jurisdictions), property rights are not limited to ownership

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162. For example, there are the first occupancy, labor-desert, personality and utilitarian theories. See Dukeminier & Krier, Property, 132-38 (2d ed. 1989).

163. See, e.g., Karl Marx, Capital 41-48 (Frederick Engels ed., 1906).

164. The concept of personal property raises the issue of personhood, which is not relevant to the thesis in this article. For a discussion of the relationship between property and personhood, see Margaret J. Radin, Property and Personhood, 34 Stan. L. Rev. 957 (1982).

165. In essence, externalities are a function of transaction costs and they encourage the misuse (the inefficient use) of resources. See Demsetz, Toward a Theory of Property Rights, 57 Am. Econ. Rev. 347, 348 (1967).

rights. Most legal systems have fragmented the robust unitary concept of ownership into a more shadowy bundle of rights, such as the right to use (e.g., leasehold arrangements) or the right of possession. In addition, rights of use and profit, among others, can be parceled out along a temporal dimension as well — one might transfer control over one's property to one person for one day, to another person for the next day, and so on.[166]

When looking at the statutory language in the Civil Law, one also finds the concept of ownership to have been fragmented into a bundle of rights. As discussed, articles 80 to 83 provide five kinds of "property rights related to ownership," one of them being the operating rights of state enterprises.[167] Upon closer inspection, however, the operating rights as defined in the Civil Law and the State Enterprise Law do not constitute a well-founded property right. At best, operating rights are only conditional, provisional powers subject to contingent trumping by the state. In other words, the state-enterprise property relationship is like an incomplete contract, with only one party, the state, supplying additional terms on an ongoing basis.[168] Since the enterprise has no power over the contract terms and does not have complete control over the underlying properties, it is hardly surprising that the enterprise enjoys only limited autonomy.

One of the central facets of a property right is that the holder of such a right possesses the consent of a given society to act in particular ways and to demand that the community prevent others from interfering with the holder's actions.[169] In this respect, Chinese law fails to provide one of the most essential sticks in the bundle of rights that are commonly characterized as property — the right to exclude others, including the state.[170] In other words, a holder of a property right

166. For a discussion of the dissolution of the ownership concept, see, e.g., Thomas C. Grey, The Disintegration of Property, 22 Property: Nomos 69-74 (J. Roland Pennock & John W. Chapman eds., 1980).

167. Civil Law, supra note 21, arts. 80-83; see supra notes 21-34 and accompanying text.

168. For an economic evaluation of efforts to fill gaps in incomplete contracts, see, e.g., Ian Ayres & Robert Gertner, Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules, 99 Yale L. J. 87 (1989).

169. Demsetz, supra note 165, at 347.

170. In analyzing legality and market reform in Soviet-style economies, one economist has devised a two-point working definition of "economic legality": (1) a mutually consistent set of laws; and (2) a belief by the population in the stability and enforcement of these laws. See John M. Litwack, Legality and Market Reform in Soviet-Type Economies, J. Econ. Persp., Fall 1991, at 77, 78. The concept of "economic legality" and its working definition is similar to that of property rights.

should have adequate remedies available to exclude others and protect the holder's right — remedies through claims enforceable by a variety of mechanisms such as damages, injunctions and by prohibitions against involuntary transfers.

B. *Redefining Enterprise Operating Rights*

Judging by the discussion above, it is questionable whether operating rights constitute property rights. It is questionable primarily because state enterprises, even though entrusted with operating rights, cannot form any reasonable expectations about the state-owned assets under their management. Therefore, it is essential to disentangle and clarify the state-enterprise property relationship and to redefine enterprise property rights.

1. Operating Rights as Independent Property Rights

Current statutory law does not draw a bright line between the ownership rights accruing to the state as the owner of state assets, on the one hand, and the operating rights of the state enterprise to use, possess and dispose of these assets, on the other hand. For the state-owner, therefore, there is always a "greater includes the lesser" ownership claim to be asserted against state enterprises. After all, divided claims such as possession, use or disposal only aggregate to equal the ownership rights. Consequently, the operating rights of an enterprise to possess, use and legally dispose of properties amount to very little. This is because the state, in its capacity as the owner, can trump the enterprise operating rights at will,[171] either by promulgating new regulations or simply by issuing directives.[172] This is particularly the case because China lacks an independent judiciary. As a result, state

171. The Civil Law provides strong protection for ownership by all the people. Article 73 stipulates: "State property is sacred and inviolable: It is forbidden for any organization or individual to interfere with possession or to loot, secretly divide up, divert for personal use, or destroy [it]." Civil Law, supra note 21, art. 73.

172. Many provisions in the State Enterprise Law empower the state to trump the management rights of state enterprises. Examples include: "in accordance with the law" (articles 2, 3 and 6); "within the scope prescribed by law" (article 13); "under the guidance of State plans" (article 22); "unless State Council regulations prescribe otherwise" (article 24); "in accordance with State Council regulations" (articles 26-29). State Enterprise Law, supra note 37, arts. 2, 3, 6, 13, 22, 24, 26-29.

enterprises have very limited means for seeking redress for violations of written regulations.

To ensure enterprise autonomy, therefore, it is imperative that operating rights be established as independent property rights. One way (and probably the best) is to maintain a system of private ownership, where state enterprises would be allowed to own the means of production.[173] Failing that, operating rights must be recognized as rights in things — a property right pertaining to the underlying properties;[174] and it is essential that such rights be both clearly defined and legally protected.

To establish clearly defined operating rights, one should not only define operating rights with sufficient specificity but also delimit state ownership by specifying the circumstances under which the state may interfere with operating rights. It follows that, except for specifically identified situations, a state enterprise, being the holder of operating rights, should be entitled to possess, use and dispose of state-assets that are under its management. In addition, because the right of benefit is vital to enterprise autonomy, operating rights should include the right to benefit from the fruit of management.[175] Such fruit, for instance, should include income derived from the disposition of fixed assets, depreciation funds and after-tax profits.[176] To this end, relevant provisions that restrict state enterprises from exercising operating rights should be amended. For instance, articles 28 and 29 should be amended to allow state enterprises to freely allocate and use funds or profits deriving from the management or disposition of state-owned assets.[177]

Finally, in order for an independent property right to be valid and effective, the people and the holder of such right must be firmly convinced that there will be stability and enforcement of the laws. To

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173. However, politically this may be the most difficult way.

174. Although most properties in a modern capitalist economy are intangibles (e.g. stocks, commercial paper, bank accounts), here we are only concerned about fixed assets such as machinery and land.

175. In fact, the three rights of possession, use and disposition are probably sufficient to cover all the incidents of ownership. "The joining of the three rights of possession, use, and disposition in the same person reduces the bilateral monopoly problems associated with the efficient deployment of resources." Richard A. Epstein, A Last Word on Eminent Domain, 41 U. Miami L. Rev. 253, 258 (1986).

176. For a discussion of the restrictions imposed on China's state enterprises regarding use of funds, see, e.g., Howard Chao & Xiaoping Yang, The Reform of the Chinese System of Enterprise Ownership, 23 Stan. J. Int'l L. 365, 373-76 (1987).

177. Civil Law, supra note 21, arts. 28-29.

establish legally protected operating rights, it is necessary to make remedies available to the holders of such rights (i.e., state enterprises). Such remedies should include claims enforceable through a variety of mechanisms such as damages, injunctions and prohibitions against involuntary transfers.

2. Disentangling the State-Enterprise Property Relationship

To comprehend the state-enterprise property relationship, it is necessary to look to the past to see how the current state-enterprise property relationship originated in China. Most state enterprises were established in 1949, primarily through confiscation of bureaucratic capital and "enemy" property, and by redeeming capitalist industry and commerce.[178] Since then, property rights over state-owned properties have belonged to different levels of government. The first step in disentangling the state-enterprise relationship should be to straighten out the state-owned properties among all levels of government. This goal could be accomplished, for example, by establishing a central government agency where state-owned properties could be administered and valued in an efficient and coordinated manner.

The next step would be to characterize and define the state-enterprise property relationship. To help delineate this relationship, the state could enter into concession arrangements with state enterprises whereby the enterprises would pay fees (or royalties) in exchange for operating rights over specific fixed assets (e.g., land or machinery), subject only to limited reversionary powers by the state. The proposed concession arrangements would be more desirable than current practices; take land as an example. Pursuant to current practices, state enterprises obtain their land through administrative allocation without specifying the period of land use. As such, they are not required to pay user's fee because the land use is a privilege rather than a right. As a result, the government can, at any time, take the land back or reassign (*diaobo*) it

178. Shortly after the establishment of the People's Republic of China in 1949, the factories, banks and other businesses which previously belonged to the Nationalist government and "capitalists" were confiscated and converted into state enterprises. At that time, the confiscated and converted enterprises constituted about 80% of the fixed capital in industry, transportation, and light industry. Wang Liming & Liu Zhaonian, On the Property Rights System of the State Enterprises in China, 52 Law & Contemp. Probs. 19 n.1 (1989).

to other state enterprises without compensation.[179] However, under the proposed concession arrangements, the properties under management would not revert to the state without clearly specified causes and just compensation. The requirement of compensation would guard against arbitrary government action.

To promote greater enterprise autonomy, operating rights should be parceled out along a temporal dimension.[180] Theoretically, it is possible to conceive of some other configuration of rights (e.g., the state reserves the right of disposition but parcels out other rights to the enterprises). However, the temporal partition approach is most desirable because it would provide state enterprises with the greatest possible autonomy and expectations associated with property rights. Pursuant to this approach, the state would transfer operating rights (and the control over the underlying properties) to the state enterprise for a definite period of time (for example, ninety-nine years).[181] During this period, the state should refrain from interfering with an enterprise's operating rights, except for clearly specified causes (national emergencies). These self-imposed restraints on the government are essential because, if the state reserves too many reversionary powers, the principle of separating ownership from operation would be frustrated.[182]

Once the state-enterprise property relationship is clearly defined, delineated and understood, state enterprises will be able to hold the independent property rights of use, possession and disposition over their managed property. The rights will not only have their own values (which are separate from the ownership rights) but will also be freely transferable (in whole or in part). Finally, state enterprises would be able to assert their right to exclude — to prevent others (including the state) from interfering with their operating rights.

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179. Cai Zhilong, Guanyu Tudi Youchang Shiyong de Jige Falu Wenti [On Legal Issues Involving Land Use with Fees], 3 Zhongguo Faxue [China Jurisprudence] 69 (1989).

180. For a discussion of the temporal dimension of property law, see, e.g., Richard A. Epstein, Past and Future: The Temporal Dimension in the Law of Property, 64 Wash. U. L. Q. 667 (1986).

181. The number ninety-nine should not be taken too seriously. The important point is that the time period should be long enough so that the state enterprise could form substantial "expectations" over the assets under its management. For instance, pursuant to the land tenure system of Hong Kong, the formal ownership of the Crown over all land has not noticeably obstructed the commodification of land through long-term lease. See Clarke, supra note 129, at 63.

182. In the United States, the notion that full ownership includes the right to do as one pleases is subject to certain public policy limitations. See, e.g., Richard A. Epstein, Takings: Private Property and the Power of Eminent Domain (1985).

Adopting such an approach would necessarily mean that the state would relax some control over those state-owned properties that are under the management of state enterprises. However, this is the minimum price that has to be paid to promote enterprise autonomy. The hard truth remains: the more strings attached to operating rights (outright restrictions and qualifying language such as "in accordance with relevant laws and regulations"), the less operating rights are actual rights and the less autonomy state enterprises will possess. Conversely, the greater the freedom to possess, use and dispose, the greater the incentives to acquire wealth, and thus to make productive use of labor, capital and land.

3. Operating Rights and Market Transactions

China has recently announced its intention to open its doors wider to market forces by "embracing them as part of socialist economics."[183] In an effort to realize such a goal, the Chinese government will further develop its stock markets. To this end, a Chinese Securities Law has been drafted and is being discussed and revised by experts; and the drafting of a Stock Company Law will be initiated in the near future as well.[184] In addition, on a policy level, the government has decided to reduce the scope of mandatory state planning, expand market regulation of the economy and "push enterprises to the market."[185]

From a property rights perspective, a market mechanism is desirable because only when a property is transferable can it begin to attract investment to its most productive use.[186] The transferability of state-owned properties can be divided into two types. The primary type governs the concession arrangements between the state and state

183. China Opens Wider to Markets, Agence France Presse, Mar. 14, 1992, available in LEXIS, Nexis library, AFP file. In an effort to tone down the ideological retreat to a market economy, Communist Party leader Jiang Zemin has recently commented that, "In fact, markets and planning are simply mechanisms for economic adjustment, rather than factors that distinguish socialist and capitalist economies." Id.

184. Major Developments are Expected in China's Stock Markets This Year, FBIS-China, Apr. 23, 1992, at 25.

185. See, e.g., Tyson, supra note 49, at 4.

186. For instance, there has been a lack of objective indicators of successful enterprise performance in China, and the absence of objective indicators could be attributed to the irrationality of the pricing system. It is therefore necessary to establish markets where appropriate pricing signals could be found. See Perkins, supra note 3, at 161-66.

enterprises, and the secondary type governs the transfer of property rights between state enterprises and other parties.

The transferability of state-owned property is not an entirely new development in China. According to a 1988 amendment to the Constitution, land use rights may be transferred in accordance with the law.[187] Pursuant to this amendment, the government has promulgated certain regulations which were designed to regulate such market transactions.[188] The constitutional amendment is beneficial because it represents a major ideological shift toward a "commodities exchange economy."[189] The success of a securities market really hinges on the degree to which the state will allow private property rights which can be "securitized."[190]

The next step would be to allow other types of fixed assets such as machinery and equipments to become objects of transactions in the factors market. To achieve this end, state enterprises should be permitted to transfer or trade (in the market) state-owned property underlying operating rights.[191] Moreover, as holders of independent operating rights, state enterprises should be entitled to own the proceeds received on the sale, exchange, collection or other disposition of property underlying operating rights.

C. Policy Considerations

It should be noted that establishing operating rights as independent property rights would not solve all of the problems that are facing state enterprises in China. This is based on the fact that the successful reform of state enterprises requires improving the external economic

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187. Chinese Constitution, art. 10(4) (amended at the First Session of the Seventh National People's Congress, Apr. 12, 1988). Previously, land transfers were generally prohibited.

188. See, e.g., Li Peichuan, Lun Gaige Woguo Chengzhen Guoyou Tudi Shiyong Zhidu de Lifa Wenti [On Legislative Issues Regarding Reform of State-Owned Land and Use System in Urban Areas], 6 Zhongguo Faxue [China Jurisprudence] 75 (1990); Zhang Quanjiang, Lun Chengshi Tudi Shichang lifa de Jiben Yuanze [On the Fundamental Principles of Urban Land Market Legislation], 3 Zhongguo Faxue [China Jurisprudence] 75 (1989).

189. According to Marxist theories, "the hegemony of profit-maximizing buying and selling stifles the individual and social potential of human beings." Margaret J. Radin, Market-Inalienability, 100 Harv. L. Rev., 1849, 1871 (1987). For a critical review of the anti-commodities position, see id. at 1871-84.

190. For a discussion of China's securities markets and related issues, see Paul Schroeder, Rebuilding China's Securities Markets, China Bus. Rev., May-June 1991, at 20.

191. For a discussion of laws and policies concerning China's economic transition to a market economy, see generally Clarke, supra note 129.

environment as well as other internal operational mechanisms.[192] In fact, the Chinese government would not lose much control over state enterprises simply by adopting the property rights reform proposed in this article. The government would still be able to exercise extensive control through microeconomic measures,[193] through administrative directives (e.g., control over managerial appointments) or through exercising organizational control (e.g., control in its capacity as the sole stockholder of state enterprises). However, the harsh reality is this: as long as the state is intent on retaining proprietary control over the means of production, the danger of insufficient reform will linger.

The Chinese government may not yet be ready to resolve the confusion which envelops the state-enterprise property relationship by assigning independent property rights to state enterprises. A reform on this scale involves numerous difficulties — both conceptual and practical. On a conceptual level, it is important to note that in most common law and civil law jurisdictions, the concept of ownership rights is no longer morally or legally monolithic.[194] Even in capitalistic countries such as the United States, the theory of property rights tends to dissolve the notion of ownership. In pressing forward with economic reforms, Chinese leaders have called for a "liberation of thinking"[195] and recognized the need to make "positive and brave explorations" into new forms of enterprises.[196] To promote autonomy and efficiency in Chinese state enterprises, economic imperatives compel that the monolithic concept of state ownership be modified.

As for practical considerations, the proposed reform would cause some social and economic instability. One consequence of the reform, for example, would be to break the iron rice bowl system. As a result, state enterprises would no longer be able to assume past welfare functions. Another source of instability relates to the ultimate measure of organizational reform — privatization — which would abolish the

192. See, e.g., Jan Svejnar, Microeconomic Issues in the Transition to a Market Economy, J. Econ. Persp., Fall 1991, at 123.

193. For a discussion of microeconomic issues, see id.

194. Margaret J. Radin, The Consequences of Conceptualism, 41 U. Miami L. Rev. 239, 243 (1986). Note that land and fungible property — that which is held merely for investment or exchange and is not justifiably bound up with the person — is fully interchangeable with its market value in money, while personal property is not.

195. China Opens Wider to Markets, supra note 183 (quoting senior leader Deng Xiaoping).

196. China Takes Aim at the Iron Rice Bowl and Chair, The Reuter Library Report, Feb. 17, 1992, available in LEXIS, Nexis library, LBY RPT file.

state ownership system. These two policy issues, privatization and welfare functions, will be addressed below.

1. State Enterprises as Welfare Societies

The current operation of state enterprises in China contradicts the modern theory of the firm because the functioning of Chinese state enterprises cannot be justified under either transaction cost economics or through organization theory.[197] In fact, they function more as welfare societies than as production sets.[198] Workers in state enterprises claim many work benefits: schools, nurseries, housing and many other forms of welfare. The welfare functions played by state enterprises have contributed to the inefficiency within the enterprises. The cost of the benefits which accrue to state enterprise employees is "passed [on] directly to the state budget and does not represent a cost to enterprise management."[199] The massive subsidies required by state enterprises to continue functioning and to support their millions of workers have drained the state budget.

The property rights reform proposed herein, if adopted, would make state enterprises an independent entity, with profit-maximization as their primary goal. As a result, state enterprises would seek to increase efficiency in their production, rather than to assume welfare functions.[200] In seeking to compete effectively in the market and to get rid of the iron rice bowl, state enterprises would have to replace the existing welfare state with employee contracts, to restructure income according to performance and to recruit factory employees through examinations. By ending the egalitarian system of income distribution, it may be necessary to lay off the old and the infirm, as well as those

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197. For an introduction to the theory of the firm, see, e.g., Oliver Hart, An Economist's Perspective on the Theory of the Firm, 89 Colum. L. Rev. 1757 (1989).

198. Upon visiting a pharmaceutical factory located outside Shengyang, a western commentator found that the factory has "236 school teachers and vocational education instructors, and its own construction company to build the factory's roads, stores, and apartments." Another Beijing steel factory employs "approximately 135,000 staff just to grow vegetables and rice, run the schools, parks, theaters, and bakeries that support the less than 15,000 workers who actually make steel." The commentator concluded that "[u]nder the circumstances it is perhaps easy to forget that these factories were originally built to make things [vitamins and steel] — to produce — and not to provide social services." See Stepanek, supra note 8, at 447.

199. See Walder, supra note 10, at 43.

200. Efficiency should be the only criterion because it is very difficult for a state enterprise to redistribute income or provide other welfare benefits in a cost-effective manner. See A. Mitchell Polinsky, An Introduction to Law and Economics 119-127 (2d ed. 1989).

workers deemed redundant. Since such measures would go directly to the center of the entitlements enjoyed by workers and their families, these proposals would be met with considerable resistance.

The workers' welfare claims, of course, should not be ignored. In the past, the Chinese government has refused to cut off subsidies to state enterprises and to separate the property ties between the state and state enterprises. This is primarily due to the fact that penalizing an enterprise — the main vehicle of social service — for poor management would have serious social consequences in the absence of a nationwide net for the unemployed, sick and uninsured. As an alternative to the welfare benefits provided by state enterprises, the government should establish social welfare programs such as unemployment insurance.[201] Such programs are necessary not only because the state should take into account equity considerations but also because such programs would make the proposed state enterprise reforms easier to implement.

2. Privatization

The proposed reforms represent a minimalist approach a fundamental step in the direction of further reform in China's state enterprises. As the experience of Eastern European countries has demonstrated, the two phases of enterprise reform are restructuring and privatization. In the restructuring stage, state enterprises are moved out from under the control of governmental agencies and set up as independent entities (corporations) with their own governance structure. Further reforms, such as establishing equity stock enterprises or allowing market transactions by state enterprises, would then become feasible in the second stage. The important point to note is that only by making the proposed property rights reform would China be able to proceed with further reforms.

The second stage of enterprise reform involves the privatization of state enterprises.[202] As long as state enterprises remain government-

201. According to recent reports, the Chinese government is simultaneously encouraging state enterprises to focus on the bottom line while and attempting to create a social safety net that would provide security for workers. See Tyson, supra note 64, at 4. For a discussion of the policy issues regarding pension funds and the social security system in the United States, see Deborah M. Weiss, Paternalistic Pension Policy: Psychological Evidence and Economic Theory, 58 U. Chi. L. Rev. 1275 (1991).

202. For a discussion of the privatization issue, see, e.g., Vickers & Yarrow, supra note 5, at 111.

controlled or government-owned (e.g., the government as the single stockholder in every enterprise), enterprises will still not be able to perform as efficiently as privately-owned enterprises.[203] In the context of enterprise reform in Russia and the Eastern European countries, there have been differing opinions concerning the pace of the privatization process: "slow privatizers" argue that enterprises should sell off gradually after restructuring;[204] while "fast privatizers" advocate that comprehensive and rapid privatization is necessary.[205] In China, although the privatization of individual household business and collective enterprises has proceeded for several years,[206] the privatization of state enterprises raises more difficult problems. These difficulties are the reason why no socialist country, in moving toward a market economy, has come very far in this direction.[207] Hence, the slow privatizers may have a point. This is particularly the case when most Chinese state enterprises are losing money. Taking Russia as an example, one finds that the Russia government recently changed its reform measures on state enterprises by providing additional funds for state enterprises to prevent mass bankruptcy. In preparing for the eventual privatization of the state enterprise, therefore, steps such as the proposed property rights reform and breaking the iron rice bowl system should be taken as promptly as possible. Once China decides to privatize its state enterprises in the future, it may well draw upon the experiences of the Eastern European countries.

VI. CONCLUSION

The comments of this article have come full circle. To promote greater autonomy in enterprise management, the Chinese government has not only established legal principles such as a legal person and

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203. For an empirical study on the comparison of the performance of these different enterprise forms, see Boardman & Vining, Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed, and State-Owned Enterprises, 32 J. L. & Econ. 1 (1989).

204. One example is Russia, which recently decided to decrease its pace of state enterprise reform due to the political dangers resulting from unemployment problems. They Couldn't Keep it Down, The Economist, Apr. 25, 1992, at 17, ("Social pressures connected with employment will become politically dangerous."); for a discussion of the recent Russian privatization framework, see B. Scheifele, Privatizing Russia, Int'l Fin. L. Rev., Apr. 1992, at 30.

205. Fischer & Gelb, supra note 9, at 98-99.

206. See, e.g., Conner, supra note 4.

207. See Fischer & Gelb, supra note 9, at 103.

property rights, but also has introduced economic concepts such as bankruptcy and market mechanisms. These principles and measures, however, have not been successful in bringing about the desired changes to state enterprises. As this article has demonstrated, the shortcomings are primarily due to the fact that the government has simply regulated around the crux of the issue: the muddled property relationship between the state and state enterprises. Without breaking such property ties, it will be impossible for state enterprises to become independent profit-seeking entities and to achieve the goal of enterprise efficiency.

Both the theory and practice of operating rights have not worked to clarify the property relationship. Although the statutes have defined the concept of operating rights with some specificity, they have simultaneously obscured it by blurring its outer limits. The reasons are threefold: operating rights are hedged with too many open-ended qualifications (wordings such as "legally prescribed") which in effect allow the state to trump such rights at will; as holders of operating rights, state enterprises do not possess the right to exclude others, including the state; and by reserving the right of benefit for itself, the state can easily cut or undermine the bundle of operting rights — possession, use and disposition — and in effect take a slice out of every strand. Not surprisingly, the hollowness of operating rights has, in practice, contributed to the lack of autonomy, incentive and accountability in state enterprises. This is because state enterprises, despite being holders of such rights, cannot form the crucial expectations over the state-owned assets they manage, which are the essential elements of any property right.

Central to this confused state-enterprise property relationship is whether the state will be willing to assign ownership rights to state enterprises or, alternatively, to parcel out some (or most) of the constituent rights of ownership into a bundle of rights which are clearly defined and legally protected. If the Chinese government intends to keep the banner of state ownership intact,[208] then it should at least consider giving substance to operating rights. By creating the legal concept of operating rights and promulgating statutory provisions incorporating it, China has supplied a foundation for establishing some kind of property rights for state enterprises. It is therefore proposed that the Chinese

208. In 1987, when radical economists advised the then party boss/reformist Zhao Ziyang that the question of ownership had to be confronted, even he flinched. They Couldn't Keep it Down, The Economist, June 1, 1991, at 15, 18.

government parcel out operating rights along a temporal dimension and create independent property rights in the underlying properties. The state could implement this by entering into concession arrangements with state enterprises, pursuant to which enterprises would make royalty payments to the state in consideration of the independent property rights they acquire. As holders of such independent operating rights, state enterprises would enjoy the right to possess, use, benefit from and dispose of property under their management, subject only to limited reversionary powers of the state.[209]

In proposing such property rights reform, it is not assumed that these reforms will comprise the optimal measure, nor is it assumed that the reforms will be easy to implement. As the experience of Eastern Europe has demonstrated, thorough reform of a socialist economy probably calls for the total abolition of state ownership. Consequently, the proposed reform — a minimalist approach — should be pursued only if the banner of state ownership is to be kept intact for political or policy reasons. In addition, although the proposed reform does not call for the total abolition of state ownership, it does signify a significant retrenchment of state control over the state enterprise. Even this more limited reform would require fundamental economic and political changes (e.g., workers' welfare entitlements); and such reform will work only if coupled with other macroeconomic measures such as pricing reform. As this article has demonstrated, to regulate around the problem is no solution. As such, in designing the appropriate state-enterprise property relationship, it should always be kept in mind that the more control the state maintains, the less autonomy the enterprise has. The reality is that as long as the state intends to retain proprietary control over the means of production, the danger of inadequate reform will remain.

It is thus clear that a properly defined property rights system is a prerequisite for successful economic reform. Hence, the proposed reform on enterprise operating rights should only be regarded as a first step toward further reforms of China's state enterprises. Successful reform of state enterprises involves some interrelated but distinct issues: property rights, organizational change, administrative supervision and

209. Of course, in addition to redefining enterprise operating rights, the Chinese government should also establish a stable legal systems guaranteeing the security of property expectations. To this end, both an independent judiciary and procedural safeguard are essential. See supra note 166 and accompanying text.

market mechanisms. Resolution of the latter three issues actually depends on the resolution of the first issue.[210] Only after the state enterprise has been assigned with independent property rights can the state make further organizational changes. One such change — privatization — could be implemented by establishing equity stock enterprises, where shares of state enterprises in turn could be sold to private investors.[211] Although the proposed property right reform is not a panacea, it is a necessary and fundamental step for further economic progress.

210. For instance, without straightening out the state-enterprise property relationship, the idea of equity stock enterprises would remain a myth rather than a reality, see supra notes 145-158 and accompanying text. In order to eliminate unnecessary administrative interference, it is necessary first to release proprietary control by establishing operating rights as independent property rights, see supra notes 126-145 and accompanying text. To push state enterprises further to the market, the state enterprise should be allowed to hold independent and tradable property rights over the assets it manages, see supra notes 171-190 and accompanying text.

211. In doing so, it is important to pay attention to the workers-as-welfare-claimants issue, see supra notes 192-195 and accompanying text.