The legal framework governing business organisations in China: gaining an understanding of its general evolution

by Xiaoyang Zhang

AN OVERVIEW

Nearly seven decades ago, after successfully weathering the storm of a three-year civil war during the second half of the 1940s, the Chinese Communist Party eventually grabbed hold of the helm of mainland China. In 1949, China's political sovereignty entered upon a new historical stage, as the nation was established afresh and re-named in the form of a new China (ie the People's Republic of China managed by a new government under the leadership of the Chinese Communist Party). The year 1949 therefore becomes an important dividing line for understanding the general evolution of China's legal framework for various business organisations available (or unavailable) to make use of at different times since then.

While prior to 1949 the widespread use of those mainstream business vehicles (such as companies, partnerships, sole proprietorships, etc) was barely a rare phenomenon in traditional Chinese societies that used to be commercially highly active and deeply market oriented, the elements of commercial capitalism had been gradually and ultimately sweepingly eradicated in the country as of 1949, due to the reasons that over a very long period of time, a Soviet-style socialist China had been arduously built up and scrupulously sustained; a ubiquitous presence of public ownership, along with a centrally-planned, centrally-controlled command economy, constituted an overwhelming force in the whole Chinese society. So any business vehicle originally designed and adopted for commercial purposes had to be mothballed permanently at that time.

It was not until the late 1970s that some long-defunct free market models started to be restored, though to only a limited degree; that, however, unquestionably unfolded an era of China commencing to experiment with a sort of economic reform and venture out into the market opening-up and liberalisation process, when in contemplating more and more great challenges to face up to in a fast-changing world as it stood then. Hence, attracting and harnessing foreign investment was touted as a flagship strategy at a time. Meanwhile, something further was brought off. In the early 1990s China's development paradigm was most noticeably repurposed into architecting a "socialist market economy"; this big change was ultimately embodied into China's Constitution. Moreover, after gaining WTO membership in 2001, China began to perform a comprehensive overhaul of the existing laws and legal institutions, especially with respect to the economic field, with a view to forging a series of new institutional regimes in compliance with those essential international norms and practices which have been widely acknowledged and taken up around the globe.

The legal framework governing business organisations in China has visibly been evolved against such a backdrop. By following a step-by-step approach, a permissible range of adoptable business vehicles is systematically going back to normal as it is now seen.

LAWS FOR FOREIGN INVESTMENT ENTERPRISES: A DISTINCTIVE STARTING POINT

During the long period since the founding of the People's Republic of China in 1949 until the late 1970s when China started to carry out economic reform and implement the opening-up policy, virtually no legal framework for business organisations could be identified in the country. Government policies and administrative regulations substituted for the laws. The dominance of a centrally-planned and centrally-controlled public ownership economy uncompromisingly dictated that most business organisations in China had to be positioned as purely state-owned, state-run enterprises. Though China's

private economy was not entirely annihilated in the initial few years in the 1950s, the non-public sectors firstly gradually and then swiftly went into extinction in the 1950s and 1960s.

With the opening-up campaign being launched in the late 1970s, the Chinese government began to set great store by attracting foreign investment from those matured economies in the West and in the peripheral countries and regions. But the absence of a legal framework governing foreign investment as well as any business vehicles to be created therewith clearly stood in the way then.

It was against that background that a string of foreign investment related laws were hammered out in the late 1970s and subsequently in the 1980s. Thus a legal framework governing foreign investment surfaced at last. A special nomenclature, "foreign investment enterprises", came into being, as the relevant laws constituting such a framework were in effect exclusively enacted around them.

Foreign investment enterprises principally encompass the following three sorts of business vehicles, in the form of which foreign firms or entrepreneurs are statutorily permitted to establish their operational bedrocks in China: (i) a Chinese-foreign equity joint venture enterprise, (ii) a Chinese-foreign contractual joint venture enterprise, and (iii) a wholly foreign-owned enterprise. The following main laws were enacted to govern these three types of foreign investment enterprises: (i) the Chinese-Foreign Equity Joint Venture Enterprise Law (1979); (ii) the Chinese-Foreign Contractual Joint Venture Enterprise Law (1988); (iii) the Wholly Foreign-Owned Enterprise Law (1986); (iv) the Implementation Decree of the Chinese-Foreign Equity Joint Venture Enterprise Law (1983); (v) the Detailed Implementation Rules of the Chinese-Foreign Contractual Joint Venture Enterprise Law (1995); (vi) the Detailed Implementation Rules of the Wholly Foreign-Owned Enterprise Law (1990); and (vii) the Rules Governing the Formation of Foreign Investment Holding Companies in China (2004).

The erection and development of this foreign investment legal regime in China, though having appeared to be somewhat incomplete and even inexplicit and erroneous in certain places, has nonetheless timely plugged the legal vacuum and set in motion a hectic campaign for foreign investment. With these foreign investment related laws and regulations quickly in place, a statutory basis on which foreign investment activities in China could generally be effectively regulated had been basically constructed in the early years of China's opening-up.

Somewhat as an innovation accomplished during a special historical stage of China's economic reform and development, the promulgation of the laws for foreign investment enterprises was in fact much earlier than the establishment of the legal regime of those mainstream business vehicles (say, in relation to China's Company Law, Partnership Law, Sole Proprietorship Law, etc). Here, it deserves special mention that the laws on those mainstream general business entities were created separately on a different track and known to be more in connection with China's domestic business organisations. In other words, there are two legal frameworks existing simultaneously at the present time, albeit their paths are more and more inevitably crossed nowadays and one day in the not too distant future, may statutorily become largely unified, if not mandated to be combined in a completely undifferentiated way.

A SEPARATE MAINSTREAM REGIME

Other than China's foreign investment legal regime, the mainstream legal framework governing Chinese business organisations pertain to the creation and development of the laws on those general domestic business entities. One of the key fronts on which China's reform endeavours had been exerted was to reinterpret the character of China's public-ownership economy and ease off some of the government's unnecessary controls on state-owned enterprises, for the purpose of establishing an advanced, modern corporate system in the country in conformity with the selected suitable economic mechanisms being applied in the mature industrialised nations.

In an orthodox sense, China's publicly-owned business organisations ought to fall into the following two categories: (i) a business organisation which is "under all people's ownership"; and (ii) a business organisation which is "under collective ownership". The former traditionally denotes a state-owned, state-run enterprise. The latter is supposed to refer to a small or medium-sized business which is neither a state-owned, state-run enterprise, nor a business undertaking which is owned privately, but is deemed to be owned by a group of domestic labourers on a collective basis.

It is worth noting that so far, four vital amendments have been made to China's current Constitution (1982) in 1988, 1993, 1999 and 2004, respectively. Each amendment engendered a momentous influence on initiating an upward trend in magnitude as regards recognising and attaching great importance to the role of the non-public sectors within China's socialist economic system.

The amendment made to the Constitution in 1988 depicted China's private economic sectors as complementing the country's socialist public ownership economic system. In such a way, it obviously ascertained the lawfulness and pertinence of embedding and promoting private economies in socialist China (which used to be something totally taboo previously).

The amendment made to the Constitution in 1993, on certain scales, led to a complete turnaround in China's strategic direction of economic advancement, as in effect it redefined

the nature of China's national economic system. As per the amendment, China officially declared to embrace a socialist market economy system as the chosen development model. The former Soviet-model of a centrally-planned, centrally-controlled command economy was thus and so abandoned conclusively. Against such a background, China's Company Law was enacted in 1993. The enactment of the Company Law architected a relatively sound legal basis for launching and operating a business vehicle in the country in the form of a modern corporate prototype. As illustrated under the Company Law, a company in China as a business organisation with legal personality may opt to take the form of a limited liability company or a company limited by shares, either of which is supposed to be a juristic person (with an independent personality, thus no longer being perceived and treated as an extended workbench of the government). This was hardly the case in the past.

But the promulgation of the Company Law in 1993 was by no means the apogee of the development of China's overall institutional framework governing business organisations. The constitutional amendments accomplished in 1999 and 2004 have done something far more significant. By virtue of the amendment made to the Constitution in 1999, the non-public ownership economy has eventually come to be deemed a vital constituent of China's socialist market economy. And in the context of the amendment made to the Constitution in 2004, developing non-public ownership economies in China ought to be massively encouraged. Hence the strategic importance of supporting the development of private economy has been considerably elevated. And with China's accession to the WTO in 2001, China's legal framework for business organisations has become significantly more sophisticated and streamlined.

In this connection, apart from the Company Law, a number of laws on other types of business organisations and their relevant operations have also been promulgated, including in the main: (i) the Partnership Law (1997) (revised in 2006); (ii) the Sole Proprietorship Law (1999); (iii) the Enterprise Bankruptcy Law (2006); (iv) the Law on Farmers' Specialised Co-operatives (2006); and (v) the Labour Contract Law (2007) (revised in 2012). Furthermore, China's Company Law has accomplished four important revisions in 1999, 2004, 2005 and 2013 respectively, in order for the substance of the legislation to become more in line with what ought to be achieved or adhered to under international best practices.

EPILOGUE

In early 2015 the Chinese government released to the public China's draft Foreign Investment Law to solicit country-wide opinion on its appropriateness. According to the provisions of this Foreign Investment Law, the passage of it will immediately invalidate the existing foreign investment related laws across the board, which, though having existed for a very long time, will be permanently shelved. If that happens, China's legal framework governing business organisations will become a single, unified whole. The current system, under which two separate regulatory regimes for domestic firms and foreign investment enterprises operate, is to be entirely dismantled, and those foreign investment enterprises will lose their special identity and be asked to transform themselves into ordinary business vehicles akin to their local Chinese counterparts; albeit unlike indigenous Chinese firms and business people, foreign investors in China will at that time be supervised by the relevant government authorities under a sort of "negative-list" approach. But all in all, the vicissitudes of the world economy and the ebb and flow of the present geopolitical tensions will play a weighty part in deciding when this Foreign Investment Law will come into force. In this context, one can only wait with bated breath to see how much further China can and is willing to go at last.

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