

An Introduction to Chinese Property Law

Jonas Alsen

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ARTICLES

AN INTRODUCTION TO CHINESE PROPERTY LAW*

JONAS ALSÉN**

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I. INTRODUCTION

1. Introduction

The People's Republic of China ("China" or "the PRC") has changed tremendously since the end of the Cultural Revolution. The economy has gone through rapid growth and the Chinese people's living standard has risen considerably. New high-rises are altering the skylines in the cities and large numbers of cars and trucks are already congesting the newly built expressways and tollroads. In the new department stores, the supply of merchandise rivals the West. The private and collective/township sectors are thriving.

However, political liberalization has not followed the rapid economic changes. While the current government is nowhere near as op-

pressive as the government during the Cultural Revolution, China today is still a one-party state with little regard for democracy or human rights. Officially, China is a communist country with a "socialist" market economy. In reality, communism is dead and China is quickly transforming itself into a society powered by brutal capitalism. However, the ideological justification for communist party power monopoly continues to be that China is still a communist society.

According to Marx, the means of production has to be controlled by the state in order to achieve a communist society. The Chinese Revolution was largely a result of the hate for abusive landowners. After the revolution, private ownership of land was abolished. However, today many factories are privately owned and the notion of a private land system exists. How does this private ownership work in a communist state? From an ideological standpoint, private ownership of the means of production and communism are incompatible, so it is interesting to investigate the structure of the current Chinese property rights system and how it works. It is the purpose of this article to try to present Chinese property law and discuss how property rights are safeguarded.

Chinese property law is still developing and its legal structure is different from that of Western law. Therefore, this article will not follow a strict Western structure by dividing property into absolute, complete rights like ownership and incomplete rights like mortgage or land-use rights. Instead, the article is divided into private (movable) property and real property (immovable).

To understand the environment that surrounds property rights in China, an overview of the Chinese legal system will be presented first. Then, property theory and private property will be discussed. As a large part of China's property is still controlled by the state-owned enterprises, the problems concerning the state-run sector will also be addressed. Additionally, financial leasing is discussed in a separate chapter to illustrate how the property system works (or does not work). Finally, real property law will be discussed.

2. Historical Background

The Preamble to the PRC's 1982 Constitution notes that "China is a country with one of the longest histories in the world." The Chinese culture developed over thousands of years more or less isolated from Western societies. Needless to say, Chinese customs and institutions developed in different directions.

The Chinese legal tradition is primarily based on two philosophies,

Confucianism and Legalist thought.¹ As early as the third century B.C., there have been tensions between and influences from both philosophies. The essence of Confucianism is the belief that desirable behavior and social harmony can be obtained through the rule of good men. The examples set by these virtuous men are the best form of persuasion. Strict regulation or severe punishment is not considered effective.² In the Confucian society, the group is more important than the individual. Conflict destroys the harmony within the group and disagreements are therefore settled through yielding and compromise. Traditionally, courts have been perceived as outside the Confucian norms of behavior and are to be avoided, since court proceedings expose the conflict and disrupt the harmony in the group.³ By contrast, the Legalist tradition insists that society can achieve harmony only if mischief is met with swift and severe punishment. The Legalists emphasize state power and control rather than morality. Law is viewed as a deterrent.⁴

These two philosophies have existed side by side throughout Chinese history, but the Confucian model behavior (*li*) has had a stronger influence on society than the written law (*fa*)⁵ promoted by the Legalists.⁶ Over the ages, criminal law was the law that developed in China. Any significant civil law did not develop due to a number of reasons. The stress on *li* in the Chinese society meant that most disputes were resolved outside courts. Those cases heard in court were all regarded as criminal cases, since there was no concept of civil wrong or tort. In Europe, the needs of commerce lead to a highly developed trade law. In contrast, commerce was quite unregulated in imperial China.⁷ Instead

1. Daoism is, of course, also an influential philosophy in Chinese culture, but in the area of law, the author has found the most influential philosophies to be Confucianism and Legalist thought.

2. LAW IN THE PEOPLE'S REPUBLIC OF CHINA 1 (Folsom, R.H. & Minan J.H. eds., 1989).

3. See *infra* section 4.1.

4. LAW IN THE PEOPLE'S REPUBLIC OF CHINA, *supra* note 2, at 2.

5. Due to the stress on the group in Chinese society, the worst punishment was considered to be banishment from this group. The Chinese character for law, *fa*, is written as a combination of the character for water and travel. It means to send somebody down the river or, in other words, banishment. Chinese law has its origins in criminal law and that is manifested by the fact that one of the original meanings of the present-day character for "law" in Chinese also meant a severe punishment. See MINFA DA CIDIAN [LARGE DICTIONARY OF CIVIL LAW] 694 (Zhang Peilin *et. al.* eds., 1991).

6. LAW IN THE PEOPLE'S REPUBLIC OF CHINA, *supra* note 2, at 2.

7. Wang Weiguo, *Some Main Characteristics of The Traditional Legal Culture of China*, 5 JURIDISK TIDSKRIFT 588, 595-96 (1989-90).

of laws, the Chinese merchants relied on trust, guarantors and a web of interlocking obligations. Guilds and other nonofficial bodies were used by the merchants to enforce contracts.⁸

An advanced property law did not develop in China. Western property law concepts were first introduced with the adaptation of the German Civil Code (Das Bürgerliches Gesetzbuch, or 'BGB') in the early 1930s, but due to the constant state of war, the laws did not have any real effect and were subsequently abolished by the communists in 1949. It was not only the influence of *li* and the lack of mercantile laws that hindered the development of advanced property laws. Historically, the Chinese emperor had a much stronger position in society than the Western sovereign counterpart. There were no strong feudal lords in China who created a balance of power that limited the options open to the sovereign. The Chinese emperor could therefore confiscate and redistribute land with considerably less difficulty than Western governments could.⁹ Since the ultimate ownership of land was vested in the government and large tracts of land were normally redistributed with the change of ruling dynasties, notions of property rights were weak. That is not to say that there did not exist any property law at all in China. There did exist a property law that sometimes was very detailed, but the law was not a strong protector of property rights.

By 1958, all land and most means of production were nationalized. Land could now only be owned by the state or the collectives. The Chinese peasants were put together into large People's Communes made up of several thousand people. Within the commune system, teams of about 40 families composed the smallest production and ownership unit. Individuals owned little more than their clothes. In the cities people worked and lived at their production units. Their apartments were owned by the work unit. Although city dwellers normally owned more property than the average farmer did, workers in general owned few things.¹⁰ Since vital property for the economy was not controlled by private interests, there was no real need for an advanced property law in pre-reform PRC.

In 1978, economic reforms began after Deng Xiaoping seized power. After that, the development of the economy went quickly.¹¹ The

8. W.J.F. JENNER & ALLEN LANE, *THE TYRANNY OF HISTORY, THE ROOTS OF CHINA'S CRISES* 139-40 (1992).

9. Powelson, John P., *Property in Chinese Development: Some Historical Comparisons*, in *ECONOMIC REFORM IN CHINA: PROBLEMS AND PROSPECTS* 165, 177 (James A Dorn & Xi Wang eds., 1990).

10. MAURICE J. MEISNER, *MAO'S CHINA AND AFTER* 153, 235 (1986).

11. Note that China's gross national product grew from 362 billion yuan in 1978

commune system was dismantled and the government contracted out farming to the peasants, creating a land-use right. Ownership of private business was allowed and by 1992, a real estate market for urban land existed and today venture capital can be raised through the stock markets.

II. THE CHINESE LEGAL SYSTEM

3. Chinese Constitutional Law

3.1. Property and the Law

The great and chief end . . . of men united into commonwealths, and putting themselves under government, is the preservation of their property.

—John Locke¹²

A well-functioning property rights system is vital for a market economy. Without a credible legal system that protects ownership rights and provides stable legal rules, people will be less inclined to invest in long-term projects when return on the investment might take many years. To sustain growth and prosperity, property rights require the protection of fair and stable laws. In a market economy, it is the task of the government to provide this security. While the current Chinese legal system does not provide this essential security, the long-term trend is positive. The Chinese legal system has substantially developed since it started from virtually zero at the beginning of reform in 1978. To understand the framework surrounding property law, it is helpful to have a grasp of the overall Chinese legal system.

3.2. Western and Communist Constitutional Philosophy

A constitution is the most fundamental of all laws and provides for the basic structure and powers of government. It enjoys the highest degree of authority and all laws of the land must have support in the constitution to be valid. On these points the Western and Communist views of the constitution coincide, but while liberal democracies see their constitutions as highly authoritative documents that serve as sta-

to 4.4. trillion yuan in 1994. STATE STATISTICAL BUREAU, CHINA STATISTICAL YEARBOOK 20-21 (1995).

12. J. Locke, THE SECOND TREATISE OF GOVERNMENT 71 (Liberal Arts Press, Inc. 1952)(1689).

ble vanguards of democracy, Communist states tend to regard their constitutions as policy documents whose theoretical supremacy does not signify the same in practice.

The Western view is that the civil liberties of citizens need to be protected from any governmental abuse. The government has to be regulated carefully by law. The law stands above the government. The different government organs are separated and regulate each other through a system of checks and balances. The citizens have enforceable rights against the government and can bring suit against governmental bodies in front of an independent judiciary. Many rights are considered natural rights that attach at birth. Therefore, rights are not given by legislation but merely protected by it.¹³

Whereas a Western constitution is meant to control the government, a communist constitution is a tool for Party rule. The way law is interpreted, implemented and modified is determined on the basis of the Party's assessment of current conditions. As in the West, the communist constitutions lay down the state structure and establish some sort of balance of power system. In reality, however, these rules have little meaning within a communist system. The formal state structure often has little to do with how power is actually controlled in the State. The supremacy of the Party means that the Constitution may be overruled, especially when there is a conflict between the actions of the top party leadership and the formal requirements and procedures prescribed by law.¹⁴ Rights are not considered to be "natural rights" that are sacred, as in Western ideology, but as rights granted by the state and subordinate to state interests. There are no natural rights. Rights are given and taken away at the discretion of the omnipotent state.

3.3. The Chinese Constitution

3.3.1. Short History and Overview

The PRC has had five constitutions. The current one, the 1982 Constitution,¹⁵ follows the 1949 (Common Program), the 1954, the 1975 and the 1978 constitutions. The 1949 Common Program served as a provisional constitution until the 1954 Constitution could be en-

13. Ian Hayne, *Development Imperatives and the "Unitary State" in Post-Mao Chinese Legal Rights* 18 (1994) (unpublished Honor's thesis, Griffith University, (Australia)).

14. CHEN, ALBERT H.Y., *AN INTRODUCTION TO THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA* 40 (1992).

15. The 1982 Constitution was adopted on December 4, 1984.

acted. This, the first real Constitution of the PRC, was closely modeled after the 1936 Constitution of the Soviet Union and emphasized the principles of "socialist legality." The 1954 Constitution soon lost legal force as it was totally disregarded in the conduct of radical economic policies and political campaigns. The 1975 Constitution was a product of the Cultural Revolution era and reflected its extreme leftist ideology.¹⁶ Due to its impracticality, it was soon replaced by the 1978 Constitution that moved away from the extreme ideology of the Cultural Revolution. However, the 1978 Constitution retained much of the same radical thinking that marked the previous constitutions, such as the emphasis on "class struggle." It lacked provisions needed for modernization. When the reformists under Deng Xiaoping seized power in Beijing, they first amended the 1978 Constitution and then adopted the 1982 Constitution, which emphasizes production and economic development.¹⁷ It also represents a return to the "socialist legality model" of the 1954 Constitution.¹⁸

All previous Chinese constitutions have been programmatic; the current 1982 Constitution is no exception. A programmatic constitution defines a mission for the state and its citizens. The aim is to turn China into a strong and prosperous, culturally advanced, democratic socialist nation.¹⁹ Laws and legally defined rights are subordinate to these overall goals of social and political development. Therefore, if the law conflicts with a specific party policy, the law and not the policy must be changed.²⁰

The power in China is, according to the Constitution, held by the people's democratic dictatorship.²¹ The "people" includes all workers, peasants, intellectuals and other patriots supporting socialism and the unity of the motherland.²² All classes do not have equal status. The state is "led by the working class on the alliance of workers and peasants" according to Article 1 of the Constitution. The leadership of the working class is exercised through its political party, the Chinese Communist Party (CPC). Thus, the domination by the CPC in politics is justified by using basic Marxist-Leninist ideological tenets.²³

16. CHEN, *supra* note 14, at 54.

17. Hayne, *supra* note 13, at 72.

18. CHEN, *supra* note 14, at 54.

19. P.R.C. CONST. (1982), pmbl., ¶ 7 (amended 1993).

20. Hayne, *supra* note 13, at 48.

21. P.R.C. CONST. art. 1.

22. CHEN, *supra* note 14, at 47.

23. CHEN, *supra* note 14, at 47.

The Constitution is the highest law of the PRC.²⁴ It is considered the "mother-law" (*mufa*), from which all other laws are derived as if they were its children (*zifa*). The Constitution has theoretical supremacy over other laws, but this supremacy has little real meaning. The Constitution is more of a guideline than a practical source of law. The implementation of more than forty provisions in the Constitution is dependent on further enactment of ordinary legislation. The Constitution contains phrases such as "according to law," "within the scope of the law," and "subject to law." It is doubtful whether the Constitution can be said to have any direct legal effect. Courts are not allowed to rely on constitutional provisions directly in deciding a case and can only apply the ordinary legislation (if there is any). Furthermore, Chinese courts do not enjoy the power of review of legislation to ensure that newly enacted laws conform to the Constitution.²⁵ The Standing Committee of the National People's Congress has the power of review, but has never exercised this power.

3.3.2. State Structure and the Hierarchy of Norms

The people's power is exercised by the National People's Congress (NPC) and the local people's congresses at various levels.²⁶ Members of people's congresses at the county level and below are elected directly by the people.²⁷ The lower level of people's congress then elects the delegates of the next higher level.²⁸ The NPC is the highest lawmaking power of the PRC. It issues the laws (*falü*). There are three levels of laws. Fundamental (*geben*) law, basic (*jiben*) law, and specially enacted (*danxing*) law. The Constitution is a fundamental law. Amendments require a special two-thirds majority of the NPC.²⁹ Basic laws are laws such as the *Criminal Code* and *General Principles of Civil Law*. They regulate certain aspects of social relations and provide general guidelines for specially enacted laws. Basic laws are subordinate to the Constitution and can be changed with a simple majority.³⁰ Specially enacted laws are laws that deal with one specific area like the *Economic Contract Law*, the *Trademark Law*

24. P.R.C. CONST. pmbl., ¶ 13 and art. 5.

25. CHEN, *supra* note 14, at 46.

26. P.R.C. CONST., art. 2.

27. P.R.C. CONST., art. 34.

28. P.R.C. CONST., art. 97.

29. P.R.C. CONST., art. 64.

30. *Id.*

or the *Inheritance Law*.³¹ The NPC Standing Committee may enact and amend all laws except those which may only be enacted by the NPC itself.³² Furthermore, the NPC Standing Committee can issue supplements and amendments to the laws made by the NPC when that body is not in session, provided that the basic principles of these laws are not contravened.³³ The State Council (Council of Ministers), which is designed as an executive branch of the government, may enact administrative regulations (*xingzheng fagui*) in accordance with the Constitution and the law.³⁴ The people's congresses at the provincial level and municipalities directly under the central government may adopt local regulations (*difangxing fagui*), provided they do not contravene the Constitution.³⁵ The people's congresses of national autonomous areas may enact autonomous regulations (*zizhi tiaoli*) and specific regulations (*danxing tiaoli*).³⁶

As straightforward as the above-mentioned formal hierarchy appears, the reality is, as always, much more complicated. The titles or designations used for legislative enactments can be very confusing. A title of an enactment can be used for regulations of different levels. The result is that one cannot tell from the title which body enacted a regulation or what status the regulation holds within the hierarchy of norms.³⁷ Even from the viewpoint of formal legality, the PRC's system of lawmaking seems to be deficient in two major respects. First, there exists no effective working system to deal with the problem of inconsistencies between legal norms derived from different sources. A formal system is outlined in the Constitution, but no procedural rules exist. Thus, in the absence of an effective system of checks and balances, inconsistent and conflicting legislation remains in force. Second, the limitations to the law-making powers of various legislative authorities have not yet been worked out. There is no effective delineation of the legislative responsibilities between the different legislative bodies.³⁸

31. Hayne, *supra* note 13, at 75.

32. P.R.C. CONST., art. 67(2).

33. P.R.C. CONST., art. 67 (3).

34. P.R.C. CONST., art. 89 (1).

35. P.R.C. CONST., art. 100.

36. P.R.C. CONST., art. 116.

37. Chen, *supra* note 14, at 88.

38. *Id.* at 90.

3.3.3. Legal Rights and Duties

As already mentioned above, the Western idea of rights is very different from the views held in the PRC. In the West, rights are often regarded as natural and universal. They have not been granted by public power and, particularly in the United States, they cannot therefore be removed by legislation. Rights limit legislation, rather than vice versa.³⁹ In the PRC, rights need to be given by the state and can therefore be taken away by the state. Law and legally defined rights are subordinate to the interest of the state. Western style constitutional guarantees of human rights and freedoms in capitalist countries are regarded by PRC ideology as only benefiting the capitalists. Since the means of production and the political power are in the hands of the capitalists and the system is one of exploitation of the masses, the legal protection given to the workers is illusory. The constitutional guarantee of the right to private property has been especially criticized by PRC jurists, who draw attention to the substantial inequalities existing in capitalistic countries that are hidden under a legal provision for formal equality.⁴⁰

Chapter 2 of the Constitution contains a list of legal rights and duties. The rights provided for can be said to be comprehensive, even by Western standards. Chinese jurisprudence classifies the rights and freedoms provided for in chapter 2 into at least eight categories:⁴¹ (1) the right to equality before the law; (2) political rights and freedoms, such as electoral rights, freedom of speech, publication, assembly, association, procession and demonstration, the right to lodge complaints and charges against state organs or functionaries and the right to compensation for infringement of citizens' rights by state organs or functionaries; (3) religious freedom; (4) personal freedom; (5) social and economic rights, such as the right to work and rest; (6) cultural and educational rights, such as the right to receive education and to engage in scientific research, literary and artistic creation, and cultural pursuits, (7) rights relating to women and the family; (8) rights of overseas and returned Chinese people.⁴²

39. Hayne, *supra* note 13, at 18.

40. CHEN, *supra* note 14, at 51.

41. *Id.* The number of rights depends on how the rights are classified.

42. P.R.C. CONST. arts. 33-50. In the CIVIL CODE, arts. 98-105, the rights of the citizen are to some extent clarified. For instance, art. 103 of the CIVIL CODE provides that any person has the right to choose his own spouse and art. 104 states that women enjoy the same rights as men. General Principles of the Civil Law of the P.R.C. [CIVIL CODE], 6th Nat'l People's Cong., 4th Sess. (effective 1987).

The right to equality under the law carries significant importance in the PRC due to its recent history. Since the Anti-Rightist Campaign in 1957, institutionalized discrimination was practiced against tens of millions of people due to their "class origin." Each person was given his class origin according to his family background. Persons of "bad" class origin, like landlords or rich peasants were discriminated against in nearly every part of life. In criminal proceedings, the law was not applied in the same way against somebody with a "good" background. The class enemy always received harsher sentences. This practice has been more or less eliminated since 1976.⁴³ As opposed to earlier constitutions, new articles on protection from arbitrary arrest, detention, and search, reflect the bitter lessons of the Cultural Revolution era's gross violation of human rights.⁴⁴

A property rights guarantee is nowhere to be found in Chapter 2. Instead, Articles 10-13 in Chapter 1 deal with property rights. A constitutional amendment in 1988 acknowledged the existence of private business and granted it constitutional protection.⁴⁵ What can, with restrictions, be called economic ownership of land has also been protected by that amendment.⁴⁶ The state protects the right of citizens to own lawfully earned income, savings, houses and other lawful property.⁴⁷ This property can also be inherited.

The legal rights given to PRC citizens seem to extend to non-citizens, since the PRC "protects the lawful rights and interests of foreigners within Chinese territory."⁴⁸ Foreign investment in China has even received its own constitutional protection in article 18 which states that foreign enterprises' "lawful rights and interests are protected by the law." However, as with many other articles in the Constitution, it is very unclear what is meant exactly by those "lawful

43. CHEN, *supra* note 14, at 52. WOLFFHART A. VON HERRENKIRCHEN, *DAS STRAFRECHT DER VOLKSREPUBLIC CHINA UNTER BESONDERER BERÜCKSICHTIGUNG DES SOWJETISCHEN STRAFRECHTS* 19-20 (1993).

44. P.R.C. CONST. arts. 37-40. While these articles are important, it must be pointed out that these are rights of the citizens against arbitrary use of power by the bureaucracy as opposed to protection against abuse of power by the elite. This is in line with the Chinese tradition which allows conflict in relationships between citizens and the bureaucracy, but less readily permits of conflict between the ruler and the ruled. The Chinese governmental tradition is that unity and identity exist between the ruler and the ruled. This is the very rationale for Party leadership in the first place. See Hayne, *supra* note 13, at 73.

45. P.R.C. CONST. art. 10, ¶ 4 (amended 1988).

46. P.R.C. CONST. art. 10.

47. P.R.C. CONST. art 13.

48. P.R.C. CONST. art. 32.

rights” and “in accordance with the law” clauses.

The last few articles in chapter 2 of the Constitution state the duties of the citizen. These include: “safeguarding the country’s unity; observing the law, labor discipline, public order, protecting state property; safeguarding the security, honor and interests of the motherland; performing military service; and paying taxes as required by law.”⁴⁹ The most significant of the duties is the citizen’s duty, in exercising his or her freedoms and rights, not to infringe upon the interests of the state, of society or of the collective, or on the rights of other citizens.⁵⁰ This means that all the rights stated earlier in chapter 2 are only guaranteed as long as they are in the interest of the state.⁵¹ It should be noted too, that neither the list of rights nor the list of duties in chapter two of the Constitution is exhaustive.⁵²

4. Dispute Resolution

4.1. Different Means of Dispute Resolution

There are four types of dispute resolution in China: mediation (*xieshang*), conciliation (*tiaojie*), arbitration (*zhongcai*), and court verdict (*panjue*).⁵³ If mediation is used, a mutually satisfactory solution based on voluntary negotiations between the parties is attempted. Should this first step not bring about success, conciliation can be the next resort. The People’s Conciliation Committees are one of the organs used for this purpose. However, the settlement is not legally binding. If the conflict is not voluntarily solved, a choice has to be made between arbitration or court verdict. In commercial disputes, the choice between them has often been regulated by contract. The Chinese make a distinction between procedures where a foreign entity is involved and

49. P.R.C. CONST. arts. 52-56 (non-American spelling used in the original translation).

50. P.R.C. CONST. art. 51.

51. CHEN, *supra* note 14, at 53. This subordination of individual rights to state interests is consistent with the Marxist tradition. The Deng regime has repeatedly stressed that any exercise of constitutional rights and freedoms that violates any of the “Four Basic Principles” is unconstitutional and unlawful. The four principles (keeping to the socialist road, upholding the people’s democratic dictatorship, insisting on the leadership of the Chinese Communist Party, and Marxism-Leninism-Mao Zedong thought) are enshrined in the preamble to the 1982 Constitution. They were first introduced by Deng Xiaoping in March 1979 as a response to the Democracy wall movement of 1978-79. *Id.* at 53 & n.92.

52. CHEN, *supra* note 14, at 51.

53. Matthias Steinmann & Dunja Stadtmann *Das neue chinesische Schiedsgerichtsbearbeitungsgesetz: Einführung und Übersetzung*, CHINA AKTUELL, Jan. 1995, at 45.

purely domestic arbitration. Arbitration involving foreigners is done by the China International Economic and Trade Arbitration Commission (CIETAC) and the China Maritime Arbitration Commission (CMAC). A choice between Chinese and other arbitration institutes has also often been regulated by contract between the parties. If court is chosen, the dispute will normally be taken to the appropriate division of the People's Court.

Informal solutions to resolve conflicts have a long tradition in China. This is explained by the interplay of Confucian values and the unattractiveness of the imperial court system.⁵⁴ Disputes within the family clan were solved by the families themselves. Even outside the family circle, court disputes were avoided. To bring a dispute to court was seen as a failure for the family bringing the suit. It disrupted the harmony. Indeed, for that very reason, government officials in Imperial China are said to have discouraged litigation by imposing penalties on those bringing a lawsuit.⁵⁵ The legal system has in all times been viewed with suspicion by the people. The people's idea of the law was that of criminal law only. To this day, particularly among the rural population, the overwhelming view is that law is not a means to enforce legal rights. Rather, law is a tool of the state to control and punish the people.

However, since 1978, the conciliation committees, which can be divided into neighborhood, work unit and village committees, have declined in popularity, particularly in the major cities. There are a number of reasons for this. The government has been promoting law as a valued means of modernization and people see courts more and more as an alternative. Furthermore, informal neighborhood justice is increasingly associated with the lawlessness of the Cultural Revolution when it became a tool for oppression. In addition, the committees have received a reputation for incompetence.⁵⁶

54. Rob Jagtenberg & Annie de Roo, *Dispute settlement in China: Law or policy?*, in ADMINISTRATIVE REFORM IN CHINA SINCE 1978, 27, 30 (Dong Lisheng ed. 1994).

55. Lucie Cheng & Arthur Rosett, *Contract with a Chinese Face: Socially Embedded factors in the Transformation from Hierarchy to Market 1978-1989*, 5 JOURNAL OF CHINESE LAW 143, 160 (1991).

56. Jagtenberg & de Roo, *supra* note 54, at 35. The committees are also an integrated part of the local system of public control and supervise a range of activities, including family planning and housekeeping chores that in other societies might be considered private concerns. In some urban communities, these committees are heavily identified with the elderly women who dominate the inhabitants with a maternalistic or officious (depending on your perspective) style of intervention in other people's problems. See Cheng & Rosett, *supra* note 55, at 198.

4.2. Court System

The "People's Courts" of the PRC are the judicial organs of the state.⁵⁷ The courts are organized in four levels. At the top is the Supreme People's Court, followed by a provincial level, a regional level, and a local level. There is a High People's Court at each provincial level, including in the municipalities of Beijing, Tianjin, Shanghai and autonomous regions. At the regional level there is an Intermediate People's Court and at the local level there is a Basic People's Court. Each court is further divided into four divisions: civil, criminal, economic and administrative. There are also special courts that deal with military, shipping, railroads, etc. The lower courts are supervised by the higher courts and each court has a so-called "adjudication committee," which reviews cases or bodies of decisions to help formulate internal guidance to the courts. Normally, cases are decided by a panel of judges, sometimes consisting of one judge and two laymen.⁵⁸ Trials are normally open to the public.⁵⁹

The President of the Supreme People's Court is elected by the NPC, which also has the power to remove the same.⁶⁰ The other judges on the court are appointed by the Standing Committee of the NPC. The term of office is limited. The People's congresses at the local level can appoint and remove local judges following the same pattern as on the national level.

China should be regarded as a statutory law country, but even this type of legal system relies on precedents. Many of the cases that leave the court of origin are distributed through internal channels and the judgments are not published. Since 1985, the PRC has published selected cases from the Supreme Court in the *Gazette of the Supreme Court*. It is unclear if these published decisions have the force of precedent or are used for general guidance only. The cases in the *Gazette* are cases from lower courts as the Supreme Court seldom tries cases itself. The Supreme Court does not simply publish the lower court's judgments. Instead, the Court might substantially edit and rewrite the cases. This liberal editing power, of course, provides the Court with an opportunity to channel its own opinions and positions to the lower

57. P.R.C. CONST. art. 123.

58. Ronald C. Brown, *The Role of the Legal Environment in Doing Business in the People's Republic of China*, INTERNATIONAL BUSINESS IN CHINA 62, 68-69 (Lane Kelley & Oded Shenkar, eds. 1993).

59. P.R.C. CONST. art. 125.

60. P.R.C. CONST. arts. 62(7), 63(4).

courts.⁶¹ Furthermore, the Chinese judges are not trained nor are they required to write court opinions that show the legal reasoning of the court. Thus, even if court judgments were published, these decisions would state the facts of the case and the judgment, but little or no legal reasoning. The lack of guiding case law is problematic for the Chinese legal system. Given China's size and population and the general phrasing of the laws, implementation of the regulations differs widely from place to place. Therefore, a substantial case law with legal reasoning is urgently needed to create uniformity in court judgments.

4.3. The Legal Workforce

The legal workforce is of shifting quality in the PRC today. Many people with legal training were either killed, imprisoned, removed from office, or chose not to practice law after the foundation of the PRC in 1949. During the first few years of the PRC, a serious effort was made to build a legal system, which was reflected in the 1954 Constitution. However, with the Anti-Rightist campaigns in the latter half of the 1950s, legality deteriorated. Many judges, scholars and other legal personnel were banished from their professions. The law schools were closed between 1957-58 and the Justice ministry itself was closed in 1959. The already weak legal system with increasingly less proficient legal personnel was completely destroyed during the Cultural Revolution. Judges and lawyers had knowledge of the old system and were therefore considered both useless for, and dangerous to the Revolution. Consequently, the legal workers were among the first to be sent to the countryside to receive re-education from the peasants.⁶² The law schools were closed again in 1966 and it was not until 1977 that they reopened. In 1981, the first students were graduated from the resurrected law schools.⁶³

China had sent its legal force into exile, dismantled the legal system and did not produce any law graduates for 15 years. When sanity returned to Beijing in the late 1970s and a legal system was reinstated, there was a severe shortage of trained legal personnel. Legal workers brought back from exile helped to fill the gap to some extent, but a

61. Lu Nanping, *Legal Precedents with Chinese Characteristics: Published Cases in the Gazette of the Supreme People's Court*, 5 JOURNAL OF CHINESE LAW 107, 114 (1991).

62. Xi-Ching Gao, *Today's Legal Thinking and Its Economic Impact in China*, 52 LAW & CONTEMP. PROBS. 89, 99 (1989).

63. Henry R. Zheng, *The Evolving Role of Lawyers and Legal Practice in China*, 36 AM. J. COMP. L. 473, 488 (1988). Beijing University alone opened its law faculty in 1974 and therefore a small number graduated from there in 1978.

large number of retired soldiers were assigned to work in the legal sector in order to fill the vacant positions. This meant that a significant part of the legal system was filled with people with little or no legal training. Large on-the-job training programs were established to educate this personnel. Even as these latter members of the legal profession are being phased out of the legal system in the 1990s, many remain. Since 1986, entrance into the profession has been by standardized examination. Today, an applicant does not need to have a law school diploma to be admitted to the bar according to the Regulations on Lawyers.⁶⁴ Other "legal training" is also allowed.

5. The Rule Of Law In The PRC

5.1. Introduction

The rule of law can be defined as a principle of government that all persons, bodies and the government itself are equal before, and answerable to, the law, and that no person shall be punished without a trial. The Chinese expression for the Rule of Law is *fazhi*. However, China has no tradition of the rule of law like or similar to the above definition. The law in China may be considered as first and foremost an instrument of state power, and only secondly as a safeguard. Twenty centuries of Imperial justice have not been conducive for the Chinese to accustom themselves to thinking in terms of rights. The rule of law did not mean protection of the individual, but expansion of state power and keeping discipline among the people.⁶⁵ The Communist party is, like the emperors who once ruled China, omnipotent and above the law. There are no solid guarantees for fairness and equity in business dealings, security of property, or protection of human rights. Because the Communist party will not tolerate free speech, free press or political opposition, let alone submit itself to the test of free and fair elections, there can be none of the checks and balances these forces provide in a more liberal society.⁶⁶

Although the above painted picture of the rule of law in PRC is rather bleak, there are positive signs. China has changed tremendously since the end of the Mao era. While still being an oppressive state, the party dictatorship today is very different from the blind terror exercised during the Cultural Revolution. The current Chinese leadership realizes that a modern commercial and economic law is instrumental in

64. *Id.*

65. Jagtenberg & de Roo, *supra* note 54, at 55.

66. *Survey: China*, THE ECONOMIST (INT'L EDITION), Mar. 18, 1995, at 4.

establishing a stable base for its continued economic development.⁶⁷ Due to the regime's emphasis on reform, many laws have been enacted. Although enforcement may still be weak, the legal system is clearly gaining ground in China.

5.2. The Independence of the Courts

Within a genuine socialist legal system, it is evident that the judiciary cannot be granted independence in the same way as in the West. The state embodies the will of the proletariat, and courts are subordinate to the highest organs of state power.⁶⁸ Officially, the highest power in China is exercised by the NPC. This organ not only makes the laws but its Standing Committee has been given the power to interpret the Constitution. Thus, the power to interpret the constitutionality of laws is vested in the chief legislative organ itself.

Although there is no separation of powers, a certain degree of specialization does exist. According to article 126 of the Constitution, the courts exercise judicial power independently and are not subject to interference by any administrative organ, public organization or individual. Theoretically, the courts are therefore independent from all other organs excluding the NPC. In reality, the courts are weak institutions under heavy influence from party and regional interests. Most of the laws are issued by the central government, but interpretation and enforcement of these regulations are local. Courts are often partial to local interests since the judges, who are often little more than petty functionaries, are frequently bowing to the wishes of the powerful bureaucrats.⁶⁹ This system creates a situation where people from other regions, not to mention foreigners, can face tremendous difficulties in acquiring and enforcing verdicts that will not favor local interests. Civil disputes are sometimes transformed into criminal offenses by courts in order to detain people and apply pressure on them or their companies to pay another party.⁷⁰ Furthermore, local officials have been reported to use their own forces instead of the courts to settle lawsuits. Even if the courts wished to end this type of unlawful self-help, the manpower available to the officials breaking the law is often superior to that of the

67. Carl Goldstein, *Ailing Legal System, CHINA IN TRANSITION* 29, 29 (Frank Ching, ed., 1994).

68. Jagtenberg & de Roo, *supra* note 54, at 55.

69. Goldstein, *supra* note 57, at 30.

70. See FAR EASTERN ECONOMIC REVIEW, Apr. 6, 1995, at 22.; see also Susan Finder, *Inside the People's Courts: China's Litigation System and the Resolution of Commercial Disputes*, CHINA LAW & PRACTICE, Feb. 1996, at 16, 20.

courts. As a result, the authority of the courts is severely undermined.⁷¹ The central government is aware of the regional protectionism and is working to strengthen the legal branch of government. However, since the strength of the regions is growing, it has become harder to enforce the will of the central government than at any other time since the revolution. It will take a long time before the courts, especially outside the biggest metropolitan areas, can be relied on as competent, powerful and impartial decision-makers.

5.3. Law and Policy⁷²

While legal reform has strong momentum in China, the current regime's view on justice is discouraging. There exists a formalistic reliance on institutions and procedures without regard for substantive justice. For instance, power abuses are not regarded as wrong due to the injustice inflicted on a party, but rather because the abuses deviate from regime policies.⁷³ In other words, it is not as important for an action to be just as it is for the action to be in line with Party policy. Regime policies change with time; that is the nature of government. One of the principal functions of law is to provide stable playing rules within which the government policies must act. In a legal system where policy is regarded as more important than law, there can be no true rule of law.

III. PROPERTY LAW

6. Property Theory

6.1 Introduction

There is nothing which so generally strikes the imagination, and engages the affections of mankind, as the right of property; or that sole and despotic dominion which one man claims and exercises over external things of the world, in total exclusion of the right or any other individual in the universe.

—WILLIAM BLACKSTONE, COMMENTARIES *2.

All societies impose at least some limitations on what may be

71. Finder, *supra* note 70, at 20.

72. See also section 4.2 *infra* on law and policy.

73. Pitman B. Potter, *Riding the Tiger: Legitimacy and Legal Culture in Post-Mao China*, 138 CHINA QUARTERLY 325, 329 (1994).

owned privately and on what may be the proper use or disposition of private property. Even a man who always claims exclusive rights, can rarely exercise those rights in total exclusion of any other. Ownership rights are seldom absolute. Many things, such as dwellings, cannot be used or transferred without having any restrictions at all placed on them. Instead of absolute rights, ownership should be seen as a bundle of rights held by the property owner. Therefore, the question of control over property becomes one of degree of ownership. Acceptable degrees of ownership are in turn enforced through a legal system.

In a socialist society, the level of permissible private ownership is lower than that in a capitalist society. In communist theory, the control of property has long been viewed as the key to success of the socialist revolution. To create a socialist society and give this order an economic power base, Marx meant that all means of production had to be controlled by the state. Private ownership of these means had to be abolished. This would deprive the exploiting capitalists of their powerbase and bring the working class to power. Public ownership is viewed as vital to assure that the means of production will be used for the good of many instead of the enrichment of a few.

In line with Marxist theory, the industries in the urban areas as well as the arable land in China were all confiscated during the 1950s. The state created huge state enterprises that became small societies in their own right, caring for food allowances, health care, housing, schools and the retired workers. In the countryside, the government created collectives of the villages and then, in turn, integrated the collectives into huge people's communes comprised of approximately some 5000 households each. These mammoth units (*danwei*) made sense from a communist ideological standpoint, but they often did not make economical sense.

Realizing that a centrally-planned, state-run economy was not leading to economic prosperity, the Deng government changed course and began to allow a degree of private ownership in 1978. The commune system was abolished and the land was contracted out to the farmers. The state encouraged small scale, light industry operated by collectives in the rural areas. In the cities, small private enterprises in manufacturing and services were encouraged. As the economy grew, large privately-run companies appeared. These firms employed many people and the owners did not themselves engage in labor. Such people looked very much like capitalists. As China was on its way to being transformed into a capitalistic society, it became harder theoretically to justify communist rule and the power monopoly exercised by the CCP. This problem was solved by arguing that China was still in the "pri-

mary stage of socialism" (*shehuizhuyi chuji jieduan*).⁷⁴ According to this theory, the Chinese society had bypassed an essential stage of economic order by going directly from a feudal peasant society to a socialist society. To reach the goal of a real communistic society where the state eventually would wither away, a stage of market economy had to be experienced. This primary stage is expected to last one hundred years from the 1950s. Public ownership plays the dominant role even during this phase of development, but private ownership is also permissible. It is acknowledged that the private sector of the economy involves wage labor and this will lead to unequal income, but this is tolerated since the private sector provides employment and helps meet people's needs. Moreover, Chinese theorists argue that private enterprise in China is meant to be different from private enterprise elsewhere (i.e., capitalist societies) because it developed long after China's socialist transformation. The public sector clearly occupies the dominant position in the economy and the owners of private enterprise are expected to use most of their profits in expanding production instead of using it for personal consumption.⁷⁵

The "primary stage" theory provides an ideological justification, however weak, for the permittance of private ownership of property and the development of private business in the Chinese socialist society. Legal protection for private business was given in a 1988 constitutional amendment article 11 not long after the launch of this theory.⁷⁶

6.2. Concept of Property

The Chinese word for property is *caichan*, which includes both tangible and intangible property.⁷⁷ The latter includes intellectual property rights such as patents, trademarks, copyrights and any other scientific or intellectual achievements.⁷⁸

Tangible property is by Chinese jurisprudence divided into specific property (*tedingwu*) and class property (*zhongleiwu*).⁷⁹ The former refers to identifiable items such as a painting or a building, and the latter

74. Allison W. Conner, *To Get Rich is Precarious: Regulation of Private Enterprise in the P.R.C.*, 5 J. OF CHINESE L. 1, 14 n.66 (1991). The "primary stage" theory was first launched by the then CCP general secretary Zhao Ziyang in a speech to the CCP Thirteenth National Congress in October 1987. *Id.*

75. *Id.* at 14.

76. *See* section 7.4 *infra*.

77. *See* MINFA DA CIDIAN 97-98, 343, *supra* note 5.

78. *Id.*

79. MINFA XUE [STUDIES IN CIVIL LAW] 90, 94 (Zhang Li & Wang Zuotang eds., 1994).

refers to property that has common characteristics and can be measured and determined by quantities or types, such as rice. When a piece of class property is separated from its class, it becomes identifiable and is then considered specific property. There are mainly three areas where this distinction has legal effect. First, if a contract is made to use specific property, the same piece of property must be returned, but if class property such as rice is used, it is sufficient to return the same kind of product of identical quantity and quality. Second, if specific property is destroyed prior to delivery, the seller is relieved of his duty to perform, but in the case of class property, the seller is not relieved of the same obligation since the delivery can be replaced by a new shipment. Third, specific property is transferred when the contract is entered into, whereas class property is transferred when the goods are actually delivered. This last distinction has lost its relevance after the promulgation of the *General Principles of Civil Law*⁸⁰ (colloquially known as the Civil Code) in 1987. The new law provides a uniform rule in article 72 that governs transfer of both types of property. Under this article, property is transferred when the goods are delivered unless the parties have stipulated otherwise.⁸¹

As with most other legal systems, Chinese jurisprudence differentiates between movable and immovable property. The latter, which cannot be removed, is real property. To transfer real property, or land-use rights, a registration procedure has to be followed. A registration of movable property is only required when vehicles, ships, airplanes and securities are involved.⁸²

Another distinction made in Chinese jurisprudence is between severable and unseverable property. The former refers to property that can be divided without changing the intended utility or harming the expected use of the thing, like a shipment of grain. Unseverable properties are things that cannot be divided without changing the intended utility or harming the use, like a horse. This distinction is not only of theoretical value. Severable property may be divided among different owners, but unseverable property may only be given to one owner and the rest will have to accept monetary compensation. When co-owned unseverable property is subject to debt, the owners are jointly liable for

80. See CIVIL CODE, *supra* note 42.

81. The parties may regulate their own relation in a contract, but not third party rights. The CIVIL CODE is silent on when a buyer of property gains protection from the seller's creditors.

82. Secured Interests Law of the P.R.C., arts. 41-43, 8th Nat'l People's Cong., 14th Sess. (1995). Nationwide real estate mortgage and chattel registration systems are provided for in this law.

the debt, which would not be the case if the property could be divided.⁸³

Other classifications include the distinction between the main property (e.g. lock) and subordinated property (e.g. key) and between the original property (e.g. tree) and accrued property (e.g. fruit). Unless law or contract provides otherwise, the rule is that subordinated or accrued property is transferred when the main or original property is transferred.⁸⁴

The classifications above have been stated in Chinese jurisprudence. Other classifications of property can be found in statutory law, which divides property into (1) state property, (2) collective property and (3) individual or private entity property.⁸⁵ This classification was inherited from Soviet legal thinking and is increasingly criticized by Chinese legal scholars for its impracticality.

Property is protected by articles in the Constitution and the Civil Code.⁸⁶ However, the wording is different depending on whether the property is state, collective or individually owned. State property is "sacred and inviolable"⁸⁷ whereas collective property and "lawful property" of citizens are simply protected by law.⁸⁸ Apparently, state property is given a higher legal status than collective and individual property. It follows that if a dispute involves individual property, the first question is whether the ownership itself is lawful. For state property, there seems to be a presumption of lawfulness. This distinction may have significant implications when the property interests of the state, collectives and individuals are in conflict. Even so, the practical difference between these provisions is not so great, as the basic principle of the Civil Code is that all civil law subjects, including state institutions and citizens, enjoy equal status in civil activities.⁸⁹

83. STUDIES IN CIVIL LAW, *supra* note 79.

84. *Id.*

85. P.R.C. CONST., arts. 5, 7-10.

86. Property rights are also dealt with in the Criminal Code. The Criminal Code states in its general provisions (art. 2) that it protects citizens' ownership rights to their lawful property. Art. 31 of the Criminal Code states that those whose criminal acts cause economic loss to persons will be required, according to the circumstances, to make compensation for said loss in addition to criminal punishment. Criminal Law of the P.R.C. [CRIMINAL CODE], arts. 2, 31, 5th Nat'l People's Cong., 2d Sess. (1980).

87. P.R.C. CONST., art. 12 and CIVIL CODE, art. 73.

88. P.R.C. CONST., art. 13 and CIVIL CODE, art. 74-75.

89. CIVIL CODE, art. 3, 5.

6.3. Ownership

The definition of ownership (*suoyouquan*) is found in article 71 of the Civil Code: "Ownership means an owner's right in accordance with law to possess, use, benefit from and dispose of his own property."

This division of property rights is different from the typical western civil codes rooted in Roman law. Roman law distinguished between ownership (*dominium*) and property rights without ownership, such as possession, easements, and usufruct. The Roman system formed the basis for the formal classifications of property rights in 1804 for the French *Code Civil* and, more completely, in 1896 for the German civil code (the BGB). Even before the BGB was promulgated in 1900, the Japanese had put a more or less virtual carbon copy of it into effect in 1898. The Japanese Civil Code, in turn, influenced the Republic of China (ROC). The ROC's Civil Code, published between 1929 and 1931, acquired its terminology for the classification of property rights from its Japanese and German counterparts. Like the BGB and the Japanese Civil Code, book 3 of the ROC's Civil Code is titled "Rights in Things" (*wuquan*)⁹⁰ and deals with ownership, possession, easements, liens, and mortgages as well as related matters such as joint ownership and registration of rights.⁹¹

The ROC's Civil Code was abolished on mainland China along with all other ROC laws by the communists in 1949, because the bourgeois laws were regarded as having no place in the new socialist republic. Drafting of a PRC Civil Code began in the 1950s but was never completed. In spite of the civil code never having been put into effect, it was influential as later date Chinese legal textbooks were often based on its thinking.⁹² The acute need for a statutory property rights system became evident after the economic reforms began in 1978. To satisfy this need, the government promulgated the Civil Code on January 1, 1987.⁹³

As stated in article 71 of the Civil Code, the Chinese concept of

90. The German term is *Sachenrecht* and the Japanese term is *Bukken*.

91. 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 AND CONTEMPORARY PROBLEMS* 176, 183 (1989).

92. *Id.* at 181.

93. See *CIVIL CODE*, *supra* note 42. Chinese legal scholars do not like to call the *General Principles of Civil Law* a civil code, because they want to reserve that name for a more comprehensive *CIVIL CODE* in the future. However, since the law is a civil code, albeit short and incomplete, most Western legal scholars call it the "Civil Code." Interview with Wang Weiguo, Professor of Law, Chinese University of Politics and Law, Beijing, P.R.C. (July 8, 1995).

property ownership is divided into four constituent “powers and functions” (*quanneng*): Possession (*zhanyou*), use (*shiyong*), the right to benefit (*shouyiquan*)⁹⁴ and disposition (*chufen*).⁹⁵ These four powers and functions of ownership can be distilled from ownership individually or in combination. The reason for breaking down ownership into four constituent parts is that legal theorists can build new rights with novel combinations of the old parts. This might be described as a process of borrowing bourgeois theoretical tools to produce new “socialist” legal concepts.⁹⁶ Although property rights in the Civil Code might be classified differently, a closer look at the ownership system reveals that even Chinese civil law has its roots in the Roman legal tradition.

Textbook authors argue that in addition to ownership rights themselves, five other property rights can be found in chapter 5, section 1 of the Civil Code. These are:

- (1) The right of state-owned or collective units to “use and benefit from” land owned by the state [art. 80(1)] or things on the land owned by the state [art. 81(1)];
- (2) The right, acquired by contract, of citizens or collectives to operate publicly owned land [art. 80(2)] and things on the land [art. 81(3)];
- (3) The right of the state or collective units or citizens to exploit natural resources [art. 81(2)];
- (4) The right of an enterprise owned by the whole people (*i.e.*, state-owned enterprise) to operate property given to it by the state [art. 82]; and
- (5) Limitation of property rights necessary for the conduct of “neighborhood relationships” [art. 83].⁹⁷

These rights can be classified as “rights in things” in the sense of the German BGB and the later denounced ROC Civil Code. The first right above can be described as a usufruct (*yongyiquan*); the second right is another kind of usufruct, called a contract usufruct. The third

94. “The right to benefit” was added to legal textbooks in the 1980s. Possession or use do not seem to be prerequisites to enjoying the right to benefit. This allows for the enjoyment of unearned income, which was not permitted according to earlier textbooks and CCP theory. In the 1950s, the right to benefit was regarded as a disguise for the exploiting classes’ extraction of blood and sweat from the workers and consequently denounced. Current textbooks give such examples of right to benefit as interest from savings and eggs from a chicken. Epstein, *supra* note 91 at 185 n.26.

95. *Id.* at 185.

96. *Id.*

97. *Id.* at 188.

right, the right to exploit resources (*caikuang quan*) is more problematic when viewed from a strictly Western view of usufruct. In Roman law, a usufruct could not be consumed. This was solved by allowing the usufructuary to be the owner of the fungible goods with a duty to restore the equivalent amount to the original owner. This solution is, however, not acceptable to Chinese Civil Law, since natural resources belong to the state⁹⁸ and the land on which the resources stand is non-transferable. Chinese law solves this problem by allowing exploitation of natural resources for a fee. Since it is not the fruits of the land that are taken, but parts of the actual land itself, it seems as if the state is effectively transferring ownership. The fourth right, the right to operate, is also a form of usufruct. Neighborhood rights, the fifth civil right listed above, are property rights only in the sense that they limit the exercise of property rights by the owner or occupier of the immovable property.⁹⁹

Another property right found in Western civil codes is the right to pledge property. This right can be found in the Civil Code, but not with the rest of the property rights. Instead it can be found under chapter 5, section 2, which deals with obligations.¹⁰⁰

The Civil Code's property system has begun to move away from the Soviet-inspired division of property rights into state, collective and private. However, the Civil Code's system is still crude and needs either to be changed or supplemented by other laws. A new property law is currently being discussed in China. So far, very rough drafts of this law reveal regulation that closely follows the German system of property rights.¹⁰¹ The study group responsible for the drafting of a property law published an outline of the law in *Faxue Yanjiu (Studies in Law)*, No. 3, 1995.¹⁰²

Different categories of property rights (rights in things).¹⁰³

Chapter I General Provisions

Chapter II Ownership (*suo you quan*)

1. General Provisions

98. P.R.C. CONST., art. 9.

99. Epstein, *supra* note 91, at 191.

100. CIVIL CODE, *supra* note 42, art. 89(2).

101. See DAS BÜRGERLICHES GESETZBUCH [BGB] Drittes Buch, Sachenrecht §§ 854-1296.

102. *The Essential Train of Thought for the Formulation of the Law of Real Property* (translated from the Chinese), *Faxue Yanjiu* [STUDIES IN LAW], No. 3, 1995, at 8-10.

103. The Chinese term is *wuquan zhong lei*. In German, the title of the outline would be called *Verschiedene Sachenrechten*. Chinese legal terms tend to be closer to German terminology than Anglo-American due to the influence of the BGB.

- 2. Ownership of Immovable Property (*budong chan suo you quan*)
- 3. Chattel Ownership (*dong chan suo you quan*)
- 4. Joint Ownership (*gong you*)
- Chapter III Land-use Rights (*fang jidi shiyong quan*)
- Chapter IV Right to Use Farmland (for farming only) (*Nongdi shiyong quan*)
- Chapter V Easement (*diyi quan*)
- Chapter VI Mortgage Rights (*diya quan*)
 - 1. General Provisions
 - 2. Mortgage with Limits of Obligation (*zuigaoe diya*)
 - 3. Floating Charge¹⁰⁴ (*dong chan diya*)
 - 4. Enterprise Securities Mortgage¹⁰⁵ (*qiye caichan ji he diya*)
- Chapter VII Lien Rights (*zhi quan*)
 - 1. General Provisions
 - 2. Chattel Lien (*dong chanquan*)
 - 3. Lien on Rights (*quanli zhi*)
- Chapter VIII Right of Retention¹⁰⁶ (*liu zhi quan*)
- Chapter IX Possession (*zhan you*)
- Chapter X Supplementary Provisions

Since this proposed outline is a rough draft only, it is not certain that it will become law or that the end product will mirror this outline. However, given the current momentum for legal reform in China, it seems likely that a new property law will be passed within the next few years. This will mean a departure from the property system drawn up in the Constitution. The general strategy for legal reform among the legal scholars is more or less to ignore the Constitution when drafting new laws. When the reformed legal system is in place, the Constitution will be a "dead letter" and can be replaced with a new one that more closely resembles Western notions of a constitution. Whether or not the legal scholars and their technocrat allies are able successfully to accomplish these reforms remains to be seen.

104. "Floating charge" is British English. This resembles a blanket lien in American terminology. Everything in the company is subject to the lien, even the real estate, although a special mortgage on a particular piece of real estate would have a senior right to that real estate over the blanket mortgage. In Swedish law, the right is called *Företagshypotek*.

105. This also resembles a blanket mortgage. See *supra* note 104.

106. In the BGB, this right is called *Retentionsrecht*. Another English word is possessory lien.

A controversial suggestion in the *Faxue Yanjiu* article is that the farmers are given a real right to the land. Today, the household responsibility system (see section 11) only gives the farmers a contractual land use right. The authors argue that the farmers' rights are not sufficiently protected today and anything less than a real ownership is unsatisfactory. This is very sensitive because ever since the revolution, land cannot be owned by anyone other than the state or the collectives. To allow full land ownership could in the long run create a land-owner class, which is unacceptable to the CCP.

IV. PERSONAL PROPERTY ("MOVABLES")

7. Different Types of Personal Property Rights

7.1. Definition

In this article, personal property is defined as all movable property, except for property which has become a part of real property, such as a door or a fence. Real Property is defined as land and rights in land, for example land-use rights.

7.2. State Ownership (Ownership by the Whole People)

The Constitution states that the basis of the PRC socialist economic system is socialist public ownership of the means of production. The public ownership is divided between the state and the collectives and this property is sacred and inviolable.¹⁰⁷ The state-owned sector, or the part of the public sector owned by the people as a whole, is the leading force in the national economy.¹⁰⁸ Heavy industry and so called "strategic industries," such as weaponry, telecommunications and mass-media are reserved areas of the state. The private sector is allowed to act in certain fields of the light industry and in the service sector, but is only to be seen as a complement to the state-owned sector.¹⁰⁹

During the 1950s, all land and practically all industry were confiscated by the PRC government, which either kept the property or redistributed it to the collectives. Therefore by the mid-1950s, all land was either owned by the state or the collectives. (Real property is discussed

107. P.R.C. CONST., art. 12. See also CIVIL CODE, *supra* note 42, art. 73.

108. P.R.C. CONST., art. 7 (as amended 1993). The ownership by the whole people was changed to the ownership by the people as a whole. Any change in meaning does not seem to have been achieved by modifying the wording.

109. P.R.C. CONST., art. 11 (as amended 1988).

in section V below.) The government created state-owned companies (SOEs) where the seized company's assets were placed. The number and size of the SOEs grew rapidly as China industrialized. Following the Soviet lead, giant steel mills and other heavy industries were built. Furthermore, many of these SOEs were put far inland to protect them from feared attacks by the United States and later, the Soviet Union. Whole industries were either moved or built anew deep in the interior. The problem with this "third line"¹¹⁰ was that it not only placed these industries far from perceived enemies but also quite a far distance away from consumers and necessary raw materials.

Today, there are about 100,000 SOEs in the PRC.¹¹¹ Many are small to medium cities in their own right, operating their own schools, universities, hospitals, police, banks, shops and housing for the employed. These companies are responsible for taking care of their employees even after retirement. Until a few years ago, the company jobs could even be inherited by the workers' children. Many of the SOEs are inefficient and often produce goods that have no market. About half of the SOEs are losing money and have to be bailed out by government subsidies. This puts a severe strain on the government budget¹¹² and fuels inflation, which is running at an annual rate of 25 percent. Since the state sector consumes such a large amount of funds, less capital is available for other more efficient township and private companies that would provide better investment returns. Furthermore, the SOEs have a monopoly on many parts of the economy. These monopolies are almost always highly inefficient and therefore costly to the economy as a whole.

An obvious solution to these problems would be to put the hopeless

110. The third line was Mao's idea. He was inspired by the Soviet Union's hasty move in 1941 of part of its industry behind the Ural mountains away from the advancing German forces. Learning from that event, Mao wanted to be prepared for the awaited war with the United States. He ordered industries to move to parts of China where practically no infrastructure existed. The army was used to build railroads in these remote areas. The Sichuan and Yunnan provinces therefore got their railroads, but at a very high cost. The third line project, which in its first years were led by Deng Xiaoping, continued using up large amounts of capital until the 1970s. HARRISON E. SALISBURY, *THE NEW EMPERORS* 124-33 (1992).

111. The numbers tend to fluctuate depending on who states the numbers and on what criteria they have relied for their computations. FAR EASTERN ECONOMIC REVIEW set the number at 108,000 SOEs. Nayan Chanda, *Asia's State Enterprises*, FAR EASTERN ECONOMIC REVIEW, Feb. 23, 1993 at 48. CHINA DAILY put the figure at 70,000. CHINA DAILY, Apr. 6, 1995.

112. The subsidies to the SOEs amount to 60 percent of the P.R.C. budget deficit. FAR EASTERN ECONOMIC REVIEW, Feb. 23, 1995.

cases into bankruptcy, restructure and privatize the other SOEs, or absent total privatization, turn them into stock companies so they could use the stock market to raise capital and be less dependent on the state. The painful conventional wisdom of any market economy is well known by the Chinese leadership, but they are afraid to take action due to the destabilizing effects on society. China passed a bankruptcy law in 1988,¹¹³ but so far few companies have been forced into bankruptcy. Both serious restructuring and bankruptcy would mean massive layoffs running into tens of millions of employees.¹¹⁴ To restructure all companies more or less at once using an Eastern European style shock therapy would most certainly create social unrest in many areas. This is what the central government fears the most.

The problems are not limited to the workforce. State banks have given loans amounting to hundreds of billions of Yuan, so called "policy loans."¹¹⁵ Furthermore, the SOEs themselves are locked into triangular debt, which is what the SOEs owe each other. "A" cannot pay "B," therefore "B" cannot pay "C" and so on. Since an SOE's problems are linked to the banks, the local governments and other SOEs together, it is hard to take limited reform action. If the government wants to restructure ten companies, the debt chain will lead them to another fifty and so forth. Many SOEs are totally dependent on government loans to pay salaries and other operating expenses. The loans cannot therefore be used for investments but only for consumption to keep the companies afloat.

Privatization of these companies is not without serious drawbacks either. Many of the companies have large and costly obligations to their employees and the plants themselves are often both outdated and

113. A new Bankruptcy Law has been drafted and will probably be passed by the National People's Congress in 1996. According to one of the drafters, the new law will be a more practical document that fills the needs of a market economy. The new law has been influenced by the American Bankruptcy code and will have a company protection and restructuring system resembling the American Code's famous Chapter 11. Interview with Wang Weiguo, Professor of Law, Chinese University of Politics and Law, Beijing, P.R.C. (July 8, 1995).

114. The SOEs together employ some 110 million people. If dependents are counted, the SOEs provide livelihood for a quarter of China's population. FAR EASTERN ECONOMIC REVIEW, Feb. 23, 1995. Another problem with closing down companies is that many of the worst cases are in the backward Chinese *hinterland*. Since these regions are so far behind the booming coastal areas, the bankruptcy option is even more undesirable. *Id.* at 52.

115. The credit extended to an ailing SOE is called a "policy loan" since it is not given on commercial terms. In many cases, the loans are government handouts that the banks do not expect to get back. Henry Sender, *Political Loans?*, in CHINA IN TRANSITION, *supra* note 67, at 56-57.

poorly maintained. Therefore, private companies might not be interested in investing in these SOEs. Still, there are many SOEs that could be privatized. For the latter companies, the privatization hurdles are not economical, but ideological. According to Marxist ideology, means of production has to be owned by the state to give it an economic powerbase. If the state sells off its assets, what is the basis and justification for the CCP power monopoly?

It is against this backdrop that the property rights problems of SOEs should be considered. The companies are owned by the state but there is a rather ambiguous ownership definition. Who is responsible for the companies? The government? What branch of the government? What level of government is responsible? Who runs everyday business and what autonomy do the managers have?

The SOE property rights problem has been intensively discussed in Chinese periodicals and newspapers since the late 1980s.¹¹⁶ What government department should be responsible for a certain company can be a problem since companies are often owned by a mixture of state, local government bodies and even the military.¹¹⁷ The thorniest issue is the autonomy of the SOE itself. The debate is about how to define and realize enterprise autonomy in a socialist market economy. Enterprise autonomy should mean that the enterprise is able not only to resist interference from state administration organs in its production and commercial activities, but also to use state property as responsibly as an entrepreneur would use his own.

Realizing these problems, the government has tried to increase the SOE managers' responsibility with the introduction of management contracts and the creation of the 1984 factory-manager responsibility system. To a large extent, these reforms have not achieved their aim to separate business and politics. The ownership problem remains. In the West, large companies are normally not run by the owners directly. The owners have appointed a company board that runs the operation through a chief executive officer. In China, the State tends to interfere in the day to day operations of the SOEs.¹¹⁸ Constant owner interfer-

116. For a closer look at the ownership debate in China, see Jianfu Chen, *Securitization of State-Owned Enterprises and Ownership Controversy in the P.R.C.*, 15 THE SYDNEY LAW REVIEW 59-84 (1993).

117. An example of the complicated ownership structure is China Jialing Group, a producer of car parts in Sichuan province. The company has ten factories, each owned by different combinations of provincial and local governments and the military. See *China Stirs Its Sleeping Giants*, THE ECONOMIST (INT'L EDITION), Aug. 27, 1994 at 54.

118. To be fair, China is hardly the only country where the State has been inter-

ence makes the companies harder to operate. Furthermore, the company's resources are not necessarily the exclusive property of the firm. A Western judge could without hesitation declare that the capital is the property of the corporation since the widely held view in the West is that the property of the company differs from the property of its investors. The investors have a stake in the company equity but cannot exercise direct ownership over the company assets. In China, this is not clear. The SOEs are legal entities but the state still seems to have a direct ownership over the company assets.

The property rights situation is confusing. The party and government interference with the management of the SOEs is damaging efficiency. So far, the PRC government has been unwilling to go all the way and transform the majority of the SOEs into stock companies that could still be partly owned by the government, but whose management and property rights would be out of reach of direct interference. Given the party/government habit of interfering, merely securitizing the companies alone, is probably not sufficient to provide the companies with the necessary independence. The companies need to be at least partly privatized. So far, only a small part of the companies has been allowed to transfer shares.

The central government has tried to save its ailing firms by structuring mergers, breaking them up into smaller management units, selling shares, transferring surplus labor to service industries, and inviting foreign investment. Privatization has been largely avoided. In the end, however, a large part of the SOEs will probably have to be privatized as the government cannot afford to keep subsidizing them. The most effective way of forcing companies to be efficient is to privatize them. The official line is still that the bulk of the SOEs will not be privatized, and the state will maintain its leading position in China's economy.¹¹⁹ Even if this is only government rhetoric and many SOEs are privatized, much is likely to remain unchanged. The government is in many cases going to keep a large enough share to ensure effective control of the companies. Moreover, all Chinese companies are likely to continue to be heavily regulated by a government that believes in state-managed growth. The companies will still answer to large, powerful public or semi-public organizations and private investors are not likely to acquire all the rights they have in Western countries.¹²⁰

fering too much with state-run companies' daily operations. But the fact remains, the interference creates conflicts of interests and affects efficiency.

119. CHINA DAILY, June 21, 1995.

120. Solomon M. Karmel, EMERGING SECURITIES MARKETS IN CHINA: CAPITALISM WITH CHINESE CHARACTERISTICS, 140 CHINA QUARTERLY 1105, 1120 (1994).

7.3. Collective Ownership (Ownership by the Workers)

There does not exist much legislation on collective property. For the collective enterprises the lack of regulation is harmful, as their legal status is very uncertain. The foundation for collective property is outlined in article 8 of the Constitution:

The contract responsibility system of rural household production-related and other forms of consumer cooperatives belong to the sector of the socialist economy under collective ownership of the working people. Working people who are members of rural economic collectives have the right, within the limits prescribed by law, to farm private plots of crop land and hilly land, engage in household sideline production and raise privately owned livestock.¹²¹

The various forms of cooperative economy in the cities and towns, such as those in the handicraft, industrial, building, transport, commercial and service trades, all belong to the sector of socialist economy under collective ownership by the working people.

The state protects the lawful rights and interests of the urban and rural economic collectives and encourages, guides and helps the growth of the collective economy.

The primary task of the collectives is to cultivate the land. The collectives own the farm land and have the right to contract out land-use rights to the peasants for a maximum thirty year period. Within the contract time, the farmers have the right (with restrictions) to transfer the land to another farmer. The farmland land-use right system is discussed in section 11.

Rather unexpectedly, it is the "sideline occupations" of the collectives that have developed into a major engine of the Chinese economy. Since the agricultural reform has produced surplus labor, many peasants have been freed to pursue other occupations. A large part of this workforce has been absorbed by the new collective industries that have experienced fast growth during the last decade. These rural industries, known as township and village enterprises (TVE) are active primarily in light industry but are also found in heavy industry as well as in the service, construction and transport sectors. The TVEs are highly competitive, since they do not have protected markets as do many of the

121. The first paragraph of article 8 was amended in 1993 in order to incorporate the household responsibility system into the Constitution.

state-owned companies. The TVEs compete with each other both in the domestic and the export market. While the central government is willing to bail out bleeding SOEs, the local governments normally refuse to aid the TVEs. As a result, many TVEs go bankrupt. However, since these rural industries are small and seldom have had access to bank credit, the consequences to society are limited. Millions of TVEs fail every year, but those who survive get stronger.¹²² It is an example of survival of the fittest in the unregulated part of the Chinese economy.

The ownership structure of the TVEs differs from SOEs. In many cases the owners are units of local government on different levels. Other TVEs are owned by groups of households. In many provinces, the "collective industry" is simply a cover for private companies, that, for different reasons, prefer to be labeled as TVEs. Since these types of enterprises have developed spontaneously, almost no laws exist to regulate the TVEs.¹²³ The company forms available in China today do not fit the very special collective enterprises. Moreover, the creation of shareholding companies or limited liability corporations requires large amounts of capital, 10 million yuan (\$1.2 million) and 500,000 yuan (\$60,000) respectively. These sums are too high for collective enterprises considering that an average TVE has a fixed-asset value of 300,000 yuan (\$37,000).¹²⁴

Thus, millions of small rural companies do not fit into any company form found in Chinese law. The unsure status of the TVEs have left them vulnerable to intervention from local bureaucrats. In some areas, local governments change the ownership of the TVE or simply take away property from the companies. Furthermore, random levies and fines are frequently imposed upon the companies. A new township law is currently being drafted. The central government has promised that this law will clarify the legal status of the TVEs and protect their property rights.¹²⁵ However, considering the weak legal system in China, it remains to be seen what impact this new law will have.

7.4. Individual and Private Entity Ownership

Individual property ownership in pre-reform communist China played a limited role. All land and almost all means of production were

122. *Survey: China*, THE ECONOMIST (INT'L EDITION), Nov. 28, 1992, at 17.

123. *Id.*

124. The average assets of a TVE probably cannot be assessed with any certainty. An expatriate banker in Beijing put it like this: "There are lies, damn lies, statistics and then there are Chinese statistics."

125. CHINA DAILY, Mar. 13, 1995.

owned by the state or by the collectives, which the state controlled.¹²⁶ The individual owned his “lawfully” owned income and savings and could in fact also own his house, but not the site the house rested on. In the countryside, peasants were allowed to keep small plots and a limited amount of livestock for household needs.¹²⁷ With the beginning of economic reforms, the individual was gradually allowed to own and/or control more property. The 1982 Constitution, which was enacted in the beginning of the reforms, to some extent reflects the shift to more diverse forms of ownership.

As mentioned above, article 8 of the Constitution gives the peasants a land-use right to farm land through a contract system, and allows the farmers more freedom to engage in sideline production. The right to own and run individual businesses was recognized in article 11's first paragraph:

The individual economy of urban and rural working people, operating within the limits prescribed by law, is a complement to the socialist public economy. The state protects the lawful rights and interests of the individual economy.

The state guides, assists and supervises the individual economy by administrative control.

The term “individual economy” (*geti jingji*) refers basically to one-man operations. At the outset, these entrepreneurs were not allowed to hire other workers, but interim regulations soon allowed them to hire two “assistants” and five “apprentices.”¹²⁸ Many of these new firms soon expanded beyond a workforce of eight workers. These companies were tolerated by the government but they had no foundation in law. Often, these private enterprises were disguised as TVEs, as that was regarded as being safer than a purely private owned enterprise. As the private companies grew, it became apparent that they needed to be regulated by law. Therefore, article 11 of the Constitution was amended in 1988 by adding a third paragraph:

The state permits the private economy to exist and to de-

126. In the early 1950s, private ownership to the means of production was allowed and that right was also stated in the 1954 Constitution. However, as mentioned in section 3.3.1 *infra*, the 1954 Constitution was never properly implemented before it was swept away by the radicalization of Chinese society. CHEN, *supra* note 14, at 42.

127. Alison W. Conner, *Individual Ownership of Property in the People's Republic of China*, 21 VERFASSUNG UND RECHT IN ÜBERSEE, 430, 432 (1988).

128. Conner, *supra* note 74, at 6.

velop within the limits prescribed by law. The private economy is a complement to the socialist public economy. The state protects the lawful rights and interests of the private economy and provides guidance, supervision and control.

This article is the foundation for the private economy (*siying jingji*) in China. Private companies are allowed to exist, but only as a complement to the state sector.¹²⁹ Furthermore, the state has reserved large parts of the economy, such as most of the heavy industry sector, for the state (see section 7.2 above). The ideological justification for allowing private ownership of means of production in a communist society was the “primary stage” theory (see section 6.1 above).

According to the Civil Code, article 75,¹³⁰ the Chinese citizen today is allowed to own his lawfully earned income, savings, house, articles used in daily life, cultural objects, books and reference materials, trees, livestock and means of production¹³¹ as well as other lawful property. Lawful income includes not only the income from one’s own labor, but also any other income obtained through lawful means. Chinese legal textbooks mention trading, inheritance,¹³² income from renting a house or lending.¹³³ Moreover, income from stock certificates, patent, trademark and insurance proceeds should be lawful since these rights are recognized in the Civil Code.

A Chinese citizen may own his own dwelling,¹³⁴ but he may not acquire freehold rights to the land, since all land belongs to the state or the collectives. However, the right to an apartment can be time limited if the land the building rests on is leased from the state. Renewal of this lease can be costly. On the other hand, apartment-owners in build-

129. The most important regulation for private enterprise besides the Constitution is the Provisional Regulations of the P.R.C. concerning private enterprises, promulgated June 25, 1988 and effective July 1, 1988. *Id.* at 1.

130. The list in article 75 of the CIVIL CODE has support in article 13 of the Constitution.

131. Private interests can own many different means of production, but some areas are still restricted.

132. Right to inherited property is especially protected in Art. 76 of the CIVIL CODE.

133. Conner, *supra* note 127, at 435.

134. The Chinese people are encouraged to buy their own homes since the state wants to move away from the costly welfare state that provides cheap housing for everyone. SOEs have created construction funds that the workers contribute to, so that the SOEs can construct housing. These apartments are then sold at low cost to the workers. Another new way of financing housing construction in China is house mortgages. See CHINA DAILY, June 19 & 21, 1995.

ings erected on state land belonging to SOEs do not suffer the same risk of having to pay twice for their dwelling, because that land has not been granted with a time-limit. The complicated land-use rights are discussed in detail in section 10 below.

A Chinese citizen today can own more or less the same things a Westerner can, with the exception of land. However, even though the mere existence of these rights is a giant leap forward for China, the rights are not well protected from intervention either by other parties or the government.

7.5. Transfer of Property

The general rule for transfer of ownership is stated in article 72 of the Civil Code:

In acquiring ownership there must not be a violation of the provisions of the law. Where property is acquired through contract or other lawful means, ownership is transferred at the time the property is delivered, unless the law or the agreement of the parties provides otherwise.

This very general rule states that unless especially provided, ownership is transferred when the property is delivered. This *probably* also means that a bona fide purchaser gains protection from the seller's creditors when the property is delivered. An agreement between two parties is possibly not binding for a third party acting in good faith. This is, however, just an assumption, since Chinese law is very unclear on this point.¹³⁵

As has been mentioned in section 6.2 above, transfer of vehicles, ships, airplanes and securities must go through a registration procedure to be valid. The same applies to transfer of real estate land-use rights.

8. Leasing

Investigating a country's leasing market is reliable indicator of how well the property system works. Leasing is interesting because the lessor retains legal title even though the lessee has actual possession.¹³⁶

135. I have spoken to Chinese legal scholars and several lawyers about this specific problem, but none has been able to give me a clear answer to this question.

136. The client company who leases the equipment is called lessee in this article. The leasing companies themselves prefer to call the lessee "the end-user," since according to the leasing contract the lessee will normally end up as owner of equipment at the expiration of the lease.

That the lessee has possession of the goods makes the leasing companies especially vulnerable in a country where the property system is less developed, like China. In the absence of a reliable legal framework, actual possession often means a *de facto* ownership, regardless of who actually holds the title to the property.

Leasing is a preferred option for companies without the strong credit rating needed to go directly to banks. There are two major kinds of leases: *operational and financial* (capital) leases. An operational lease is a short-term and cancelable lease. The leased equipment is returned to the lessor at the expiration of the leasing contract. A financial lease is a long term lease and normally cannot be canceled. In effect, it is an installment purchase plan, where the ownership is turned over to the lessee at the expiration of the leasing contract. In China, financial leases are often structured as six installments over three years. Financial leasing is the most common type of leasing agreement in China today.¹³⁷ The demand for operational leases is not as large.¹³⁸

When a financial lease is entered into, a Chinese or a joint venture (JV) leasing company borrows money from a bank and uses the funds to buy equipment for the lessee. A JV company can often get funds from foreign banks whereas Chinese companies typically lack the credibility needed to borrow from that source. Under the purchase agreement between the manufacturer and the lessor, the lessee will be named as the user in the contract but the ownership will be retained by the lessor. The point of this arrangement is that the end-user may then claim warranty under the contract with the manufacturer. After the installation certificate has been signed, the leasing company has nothing more to do with the equipment. The leasing company assumes the economic but not the technical risk.

Financial leasing in China is different from the West. The payback time is very short, normally only three years. The payback time is too short to let the machines pay themselves off, but no leasing company is prepared to grant a ten year payment period (which in many cases would better reflect the depreciation) because of the market risk. Furthermore, a guarantee from a third party is always needed. If the property system was really reliable in China, a guarantee would not be needed. One major benefit with leasing in many Western countries is that the leased equipment does not show up as an asset in the book-keeping, but as a cost. The purpose is to improve the companies' debt-

137. Financial leasing has channeled \$ 4.5 billion to Chinese companies in the last 14 years. CHINA DAILY BUSINESS WEEKLY, June 11-17, 1995.

138. According to a Bank of China source.

to-equity ratio.¹³⁹ In China, the end-user lists the equipment as an asset and does not get this benefit. Since the payback period is so short, a guarantee is needed, and the way bookkeeping is done means that leasing in China is not really leasing at all, but much more like acquiring a bank loan.

A financial lease typically concerns heavy machinery or production lines, which usually are not meant to be removed. The lessor's security is the ownership of the equipment and, normally, a guarantee extended from a local bank or a company,¹⁴⁰ often a local government owned entity. The leasing companies have encountered a lot of problems when, upon failure by the end-user to pay, they have tried to get their money back. About thirty Japanese and European leasing companies have lost about \$ 600 million over the last few years in the Chinese market.¹⁴¹ Some of these losses have been caused by the way leasing companies conducted business. The solidity of the lessee and the local guarantor were not always thoroughly investigated, as the leasing companies were more focused on leasing volume than on secure investment.

First, to get a guarantor to pay on first demand is almost always out of the question, and the lessor is usually told by the guarantor to try to repossess the equipment from the lessee regardless of whether the guarantee is "on first demand."¹⁴² If all negotiations fail, the lessor is then left with the option of going to the economic section of the People's Court or arbitration¹⁴³ and trying to acquire a court order to compel the guarantor to pay, the lessee to pay or seize the property from the lessee. As discussed in section 6 above, going to court in China and then getting a court order enforced is hard at best, and often impossible, especially when the lessee company is situated outside the big met-

139. The debt-to-equity ratio shows the amount of a company's assets that are provided by creditors in relation to the amount provided by stockholders. The larger the debt-to-equity ratio, the more fixed obligations the company has, and the riskier the situation. Thus, a company with a low debt-to-equity ratio is regarded as more solid.

140. Earlier, government agencies often would guarantee loans but this is not allowed since 1988. See below for further comments. Interview with Ludwig Fella, Assistant Manager, China Universal Leasing, Beijing, P.R.C. (June 9, 1995). See also P.R.C. JOINT VENTURES: CAPITAL CONTRIBUTIONS, ASSET VALUATION & FINANCING 159 (Katrina Matthews ed., 1996).

141. FAR EASTERN ECONOMIC REVIEW, Jan. 12, 1995.

142. Gernot G. Klüss at China Universal Leasing said it like this: "I don't think some of the Chinese guarantors even know what the meaning of 'on first demand' is." Interview with Gernot G. Klüss, General Manager, China Universal Leasing, Beijing, P.R.C. (Apr. 4, 1995).

143. The economic section of the People's Court seems to be preferred to arbitration by the leasing companies. Interview with Shu Xiao Dong, Manger, Bank of China, Trust and Consultancy Co., Leasing Dept., Beijing, P.R.C. (Mar. 17, 1995).

ropolitan areas. Leasing contracts commonly used today state that the appropriate court is the domicile of the lessor.¹⁴⁴ However, even if the economic court in Beijing, for example, issues a court order that gives the lessor the right to reclaim the property, the lessor still needs to get the local court at the lessee's domicile to honor that court order to enforce the judgment. Not surprisingly, local courts are often not especially helpful to "outsiders."

Even in the event the leasing company is successful in repossessing the property and the equipment has been well maintained, a second-hand market for these types of machinery is virtually non-existent in China. The equipment will either be resold at a very low price or will sit in a warehouse, incurring costs. Given the collection costs, the unsure results of the collection procedure and the low market value of the repossessed equipment, the leasing companies usually often only use repossession as a threat and prefer a negotiated settlement when possible, even if that means that the amount recovered is significantly less than the fees owed.

Another problem encountered when trying to repossess the equipment is that the machinery has been used as the lessee's contribution to an equity JV with a foreign company and the machines have been transferred to the JV, which is a separate entity. To get the machines from the JV can be very hard if not impossible, since the JV management is likely to claim good faith (meaning the machines belong to the JV and not the leasing company). It is unclear whether a JV successfully could claim good faith, since they have at least a reasonable duty to find out who actually owns the equipment brought into the JV.¹⁴⁵ Since there is no functioning title registration system for personal, mov-

144. In the late 1980s, the contracts did not contain this clause, making enforcement of the agreement even harder. Interview with Gernot G. Klüss, General Manager, China Universal Leasing, Beijing, P.R.C. (Apr. 4, 1995).

145. See CHINA FINANCE MANUAL 17-18 (Brian W. Semkow ed., 1995). JV property rights are regulated by the Implementing Regulations for the Law of the P.R.C. on Chinese-Foreign Equity Joint Ventures, promulgated by the State Council (Sep. 20, 1983) and amended by the State Council (Jan. 15, 1986 and Dec. 21, 1987)[hereinafter the Implementing Regulations to the Equity Joint Venture Law]; and Certain Regulations on the Subscription of Capital by the Parties to Sino-Foreign Joint Equity Enterprises, approved Dec. 30, 1987 by the State Council and jointly promulgated Jan. 1, 1988 by the Ministry of Foreign Economic Relations and Trade and the State Administration for Industry and Commerce [hereinafter the Joint Venture Capital Regulations]. The regulations require assets brought into the JV to be free of third party rights. However there are a number of ways to get around the problem. The JV could get the lessor to agree to the transfer by compensating him, or the JV could refuse to let the Chinese partner use the machinery as its in kind contribution to the JV.

able property in China today,¹⁴⁶ how can the leasing company prove the JV's bad faith?¹⁴⁷ When dealing with SOEs, the circumstances are a bit different. When entering into a JV, the SOE needs to get an Asset Evaluation Report, which is a certificate issued by the State Asset Evaluation Authority that certifies that the SOE actually owns the property it contributes to the JV.¹⁴⁸ Other than trying to get the equipment back from a third party a lessor could try to get money or another asset from the lessee. However, often there are no assets of significant value to be found.

Getting compensation from the guarantor is also difficult. Often, local banks will claim they have no funds to pay the guarantee and refuse to pay, and a local court is often not willing to force the bank into paying. Local government agencies or companies will act in much the same way, claiming that they were forced to sign the guarantee and they therefore are not guilty, or claim that there is no money available to pay the guarantee. The local court is neither willing nor has the power to force the local government to honor their promises. One of the most painful lessons to learn from doing business in China is that guarantees from a local government agency are not necessarily honored and the central government does not necessarily stand behind the commitments of its SOEs.¹⁴⁹ Since 1988, government agencies are not allowed to guarantee loans or leasing.¹⁵⁰ Today, the local government creates government-owned companies which in turn give the guarantees on

146. In the 1995 Secured Interests Law, a personal property registration system is provided. The local industry and commerce administration is supposed to register liens on machinery according to articles 34 and 42. Whether or not this registration system can be used to register lessor *ownership* is unclear. However, it is likely that it will take some time before this registration system will work properly. Secured Interests Law of the P.R.C., 8th Nat'l People's Cong., 14th Sess. (1995).

147. One legal counsel put it like this: "We would of course deny any knowledge whatsoever. What can the suing party do? Claim that we are dishonest [in front of a Chinese court]?" Interview with Gernot G. Klüss, General Manager, China Universal Leasing, Beijing, P.R.C. (Apr. 4, 1995).

148. The purpose of the Asset Evaluation Report is to prevent state assets from being given away or sold below fair market value by the SOEs. The Report sets the value of the property and approves of the transfer of assets to the JV. The foreign partner normally demands to see this report. According to different lawyers in Beijing, this is sufficient proof for the foreign partner to know that the assets belong to the SOE.

149. Interview with Gernot G. Klüss, General Manager, China Universal Leasing, Beijing, P.R.C. (Apr. 4, 1995).

150. Interview with Ludwig Fella, Assistant Manager, China Universal Leasing, Beijing, P.R.C. (June 9, 1995). See also P.R.C. JOINT VENTURES: CAPITAL CONTRIBUTIONS, ASSET VALUATION & FINANCING 159 (Katrina Matthews ed., 1996).

loans and leases, thus making claims against the local government itself more difficult.¹⁵¹

To put a company into bankruptcy can be hard in China, especially if the company is state-owned. If the lessor manages to put the lessee or the guarantor into bankruptcy, the lessor may find only an empty shell, since the assets will have been moved out of the company without proper consideration. Reclamation of these assets would be difficult.¹⁵²

What then can a leasing company do to recover its investment if negotiation fails and the local court is not willing to cooperate? In some cases, talking to the city officials will help, since they will be concerned with preserving the city's reputation, especially if the leasing company is big and well-connected. Since the local government (together with the CCP) exercises significant influence over the local SOEs, banks and courts, the leasing company may end up being paid a bit of the money owed from another bank or company by order from the local government.

Sometimes this cooperation from the local government might appear to help more than it actually does, as one leasing company in the Sichuan province discovered. A company owned by the local government in Chongqing had leased some machinery from the lessor. The lease was guaranteed by a Chongqing government agency. After a while the lessee became unable to pay the fees and the lessor went to the guarantor. Unfortunately, the government agency didn't have the funds needed to fulfill its guarantee. The Chongqing city government refused to take responsibility for the guarantee and said that the only way the lessor would get its money back was to put the lessee into bankruptcy. The court went along with the bankruptcy proceedings but appraised the lessee company assets so low that the lessor ended up with little compensation after the assets had been sold off. The assets

151. The 1988 regulation that prohibited local government agencies from guaranteeing loans was not immediately noticed by the leasing companies who continued to rely on such guarantees for a long period afterwards. After 1988, when a lease guaranteed by local government agency went bad, the agencies then claimed that the agency didn't have the authority to give the guarantee and it was therefore void.

In 1991, the Guarantee Procedures regulation was enacted which further limited which organizations may give guarantees. The regulation also restricted the conditions under which a guarantee can be given. Failure to comply with this regulation will make the guarantee worthless. See Will Dennis, *Capital Contribution and Financing, in THE LIFE AND DEATH OF A JOINT VENTURE IN CHINA* 51, 61 (Duncan Freeman, ed., 1994).

152. I have spoken with drafters of a new bankruptcy law, who indicate that they are working to make it easier to reclaim property that was transferred without proper consideration. However, I suspect enforcement will still be difficult.

were bought by the city which continued the production, but now without debts. To be fair, it is not only in China one hears about these types of bankruptcy stories, but what differs is that in China the courts are not independent and take orders from the government, which in this case sets the price.¹⁵³

Aircraft leasing is the type of leasing that seems to work the best. A large part of the leasing is done through the Civil Aviation Administration of China (CAAC), which also runs airlines, some directly and others indirectly. The CAAC has decided to use leasing as a principal means of acquiring new aircraft. Since the CAAC is a big, professional government agency and airline which cannot afford not to pay if it wants to keep on leasing planes, it is regarded as a trustworthy lessee. Furthermore, airlines are regarded as solid investments because their planes usually fly full and tickets are paid in cash. Also, since many of the leased aircraft fly overseas, they are easier to repossess than other leased objects. However, lessors may need to be cautious even in this industry in the future, since the Bank of China has indicated that it may stop guaranteeing aircraft leases.¹⁵⁴

A new law to regulate the leasing industry is expected.¹⁵⁵ Even though a new regulation will help, the problem is not the actual laws in China today, but the enforcement of these laws and the general attitude towards honoring debts. The leasing companies have learned their lessons the hard way in China and are now more cautious. Leasing, as done in the West, is ill-suited for a country with an unreliable, still developing legal system. As China develops and the leasing companies learn how to act in the Chinese market, problems are likely to decrease.

V. REAL PROPERTY ("IMMOVABLES")

9. Overview

Nothing is so closely connected with the word property as land, especially so in China with its large peasant population. Promise of land reform was an important reason why the communists succeeded in rallying the peasants to their side during the civil war. Under the ensuing land reform, land was initially redistributed to the peasants with ownership rights. However, after the collectivization in 1955, indi-

153. Interview with Wang Weiguo, Professor of Law, Chinese University of Politics and Law, Beijing, P.R.C. (July 8, 1995).

154. *BUSINESS WEEK*, Dec. 19, 1994, at 11. According to *BUSINESS WEEK*, in late 1994 Chinese carriers had up to 100 aircraft on order and planned to lease at least 80 percent of them. *Id.*

155. *CHINA DAILY BUSINESS WEEKLY*, June 11-17, 1995.

vidual land ownership was abolished and formal ownership of land was transferred from the peasants to the collectives organized at the village level. Urban land was nationalized.

Still today, all land in China is either owned by the State or the Collectives. Generally speaking, all urban land belongs to the state and most rural land belongs to the collectives. The foundation for land ownership is laid out in the 1982 Constitution.

Article 9 of the Constitution states that all mineral resources, waters, forests, mountains, grass-lands, unreclaimed land, beaches and other natural resources are owned by the state with the exception of forests, mountains, grasslands, unreclaimed land and beaches that are owned by collectives in accordance with the law.¹⁵⁶

Article 10 originally stated that:¹⁵⁷

Land in the cities is owned by the state.

Land in the rural and suburban areas is owned by collectives except for those portions which belong to the state in accordance with the law; house sites and private plots of cropland and hilly land are also owned by collectives.

The state may in the public interest take over land for its use in accordance with the law.

No organization or individual may appropriate, buy, sell or lease land or otherwise engage in the transfer of land by unlawful means.

All organizations and individuals who use land must make rational use of the land.

After the collectivization, the collectives formally owned their land. In practice, however, the state assumed tight control over transfer rights including the sale, rent or exchange of land. Use rights were vested in the collective, but crop choice and sale prices were all decided by the state.¹⁵⁸ This changed with the household contract system introduced by Deng Xiaoping in 1978. The collectives still could not sell the land but were now given the right to contract out land use rights to individual farmers who paid for their rent by selling a part of their crop

156. Chinese law makes a difference between resources and the land itself. Therefore, article 9 of the Constitution regulates resources and article 10 the land itself.

157. The fourth paragraph of article 10 was amended in 1988. This is discussed later in this section.

158. Mark Selden & Aiguo Lu, *The Reform of Land Ownership and the Political Economy of Contemporary China*, in *THE POLITICAL ECONOMY OF CHINESE DEVELOPMENT* 187, 187 (Mark Selden & Aiguo Lu, eds., 1993).

to the state. The household system was a tremendous success and agricultural production increased rapidly.

A large part of the real property is managed by the SOEs, which have been allocated use rights to the land for an indefinite term without any significant compensation. Usually, the SOEs pay only a small annual fee. The land rights are limited. The SOEs cannot transfer their allocated land to a third party. However, since the early 1980s the SOEs have been allowed to use their land as in-kind contribution to a JV (provided the government approved). This right was still severely restricted and did not grant the JV the power to buy, sell or mortgage the property. In light of the current Chinese real estate boom, it seems hard to believe that land was regarded as almost worthless until the late 1980s and the acquisition of land was only a bureaucratic arrangement.

As China opened up to foreign investment, it became more and more evident that untransferable land ownership rights were not very practical. In the new Special Economic Zones (SEZ), a system that allowed the rental of state land was attempted. However, neither the Chinese nor the foreign investors were pleased with the system which required the foreign investors to pay an annual rent. The fee was specified by law, without regard to changing conditions of the real estate market.¹⁵⁹ Nor could the JVs mortgage the land as a mean of getting funds. Chinese-foreign JVs were not the only losing parties in this system. The city governments did not get much money from these short-term land use leases.¹⁶⁰ Denying others land ownership, the state itself had to bear the burden of developing land in the cities. As the State lacked funds for this development, prime real estate parcels in big cities like Beijing could lie idle for decades and infrastructure construction went slow.

However, to allow private land ownership was ideologically hard for the CCP to accept, since privatization would create new landlords, the old class enemy. The solution was to allow purchase of land usage rights which were valid for a limited duration of time. The first land

159. The fees are dealt with in the Implementing Regulations to the Equity Joint Venture Law, *supra* note 145, arts. 47-53.

160. According to official Chinese statistics, the land-use fees and other related charges that the government of the Shenzhen SEZ collected from 1980 to 1987 were only 38 million Yuan. This was not even sufficient to pay for the interest on the 600 million Yuan investment by the Chinese Government in land development and infrastructure during the same time. See Henry Z. Zheng, *The Special Economic Zones and Coastal Cities*, in *DOING BUSINESS IN CHINA*, 43 (W. Strong & A. Wilcox eds., 1993).

transfers took place in 1987 in the SEZ of Shenzhen.¹⁶¹ At that time, this practice lacked support in the Constitution, but shortly afterwards, on April 12, 1988, the fourth paragraph of article 10 of the Constitution was amended to read:

No organization or individual may appropriate, buy, sell or unlawfully transfer land in other ways. *The right to the use of land may be assigned in accordance with the provisions of the law.*

(Emphasis added.)

The same year, article 2 of the Land Administration Law was amended to allow state-owned and collective-owned land to be alienated for value.¹⁶² Detailed national regulations had yet to be issued but the legal foundation for using property as a commodity had been created. In 1990, a few years after the SEZs promulgated their land-use rights regulations, a national regulation on granting land use rights was passed.¹⁶³

The local and national land grant regulations gave land value and created a real estate market. This new market, combined with double digit economic growth, soon created a booming real estate industry. The SEZs and the major cities soon looked like big construction sites. The development sometimes went out of control. Zoning laws were disregarded and in some places, like Shanghai, office construction increased past any reasonable demand forecast.¹⁶⁴ Another result of the real estate boom was increasing corruption. Since the land-use grants involve large sums of money and are administered by poorly paid civil servants, the potential for corruption is large.¹⁶⁵ In the suburban and rural areas, large areas of precious agricultural land were taken for housing construction as the cities grew.¹⁶⁶

161. CHINA BUSINESS LAW GUIDE 9 85-620 (Sally A. Harpole ed., 1991).

162. Law of the P.R.C. on Land Management (also known as the Land Administration Law), 6th Nat'l People's Cong., 16th Sess. (1986) (amended 1986) [hereinafter LAL].

163. Provisional Regulations of the People's Republic of China Concerning the Grant and Assignment of the Right to Use State Land in Urban Areas, (1990) [hereinafter 1990 Grant Regulations].

164. *Survey: China*, THE ECONOMIST (INT'L EDITION), March 18, 1995.

165. See Finder, *supra* note 71, at 20.

166. *Growing Pains*, THE ECONOMIST (INT'L EDITION), Mar. 18, 1995 at 24.

10. Urban Land

10.1. Land-Use Rights

The national regulations concerning land use rights are the 1986 Land Administration Law (LAL),¹⁶⁷ the 1991 implementation rules to the LAL,¹⁶⁸ the 1990 Grant Regulations,¹⁶⁹ the 1992 Allocated Land Measures,¹⁷⁰ and the 1994 Urban Real Estate Management Law (UML).¹⁷¹ While also providing new provisions, the UML to a large extent repeats what already had been stated in previous legislation.

The regulations draw a distinction between urban and collective land. All urban land belongs to the state and the surrounding suburban land normally belongs to different collectives.¹⁷² Only state-owned land can be transferred to a third party.¹⁷³ Therefore, land belonging to the collectives has to be nationalized before it can be granted.¹⁷⁴

Another distinction is drawn between "Granted" and "Allocated" land. Granted land has a time limit on usage and can be transferred for value. Allocated land is given without consideration and normally has no time limit, but cannot be transferred.¹⁷⁵

10.2. Granted Land-Use Rights

The definition of a grant of land is found in article 8¶ of the 1990 Grant Regulations: "The term 'grant of the right to use land' refers to the act by which the State, in its capacity as land owner, grants the right to use land for a certain number of years to a land user and the land user pays to the State a fee for the grant of the right to use land."

The maximum time limits of the land-use right are determined by the purpose of the use.¹⁷⁶

167. See LAL, *supra* note 162.

168. Rules for Implementation of the Law of the P.R.C. on Land Management, promulgated Jan. 4, 1991 by the State Council.

169. See 1990 Grant Regulations, *supra* note 163.

170. Provisional Measures on Administration of Allocated Land Use Rights (1992) [hereinafter Allocated Land Measures].

171. Urban Real Estate Management Law of the P.R.C., 8th Nat'l People's Cong., 8th Sess. (effective 1995) [hereinafter UML].

172. LAL, art. 6.

173. See for example P.R.C. CONST. art. 10, ¶ 4, and LAL art. 2, ¶ 2.

174. UML, *supra* note 171. art. 8. That only state land may be transferred is implied in the 1990 Grant Regulations, but the UML makes it explicit.

175. 1990 Grant Regulations, *supra* note 163, arts. 8, 42-44.

176. *Id.* art. 12.

- (1) 70 years for residential purposes;
- (2) 50 years for industrial purposes;
- (3) 50 years for educational, scientific, technological, cultural, public health or sport purposes;
- (4) 40 years for commercial, tourism or recreational purposes;
- (5) 50 years for comprehensive use or other purposes.

Land-use rights may be acquired by auction, tender or agreement.¹⁷⁷ Land for commercial, tourist, entertainment and luxury residence purposes must adopt the manner of auctioning or bidding when possible.¹⁷⁸ Only if these means are impossible may bilateral negotiations be adopted.¹⁷⁹ These practices are intended to allow the market to set the price instead of artificially fixing it by law.

When the land-use right is granted, a contract shall be entered into by the State Land Administration Bureau¹⁸⁰ (SLAB) and the land user.¹⁸¹ There are different standard forms for the grant contracts. Since the SLAB normally insists upon using these standard contracts, the grantee is likely to be unable to change the major terms of the contract. As a result, the negotiations normally focus on the price and the duration of the contract and not the restrictive covenants.¹⁸²

After the grant contract is entered into, the land-user has to pay the land-use fee within 60 days.¹⁸³ If the grantee fails to pay the fee within the allotted time, the grantor has the right to rescind the contract and demand liquidated damages.¹⁸⁴ When the land-use fee is paid in full, the SLAB will issue a land-use certificate (*tud-ishiyongzheng*).¹⁸⁵ This certificate is the proof of title to the land-use right. This document is needed for transfer of the property. After the construction of the premises on the land is completed, the Real Estate

177. *Id.* art. 13.

178. UML, *supra* note 171, art. 12.

179. *Id.*

180. The Land Administration Bureau of the municipal or county People's Government is the grantor of the land-use contracts. See 1990 Grant Regulations, *supra* note 163, art. 11.

181. UML, *supra* note 171, art. 14.

182. Zheng, *supra* note 160, at 43.

183. 1990 Grant Regulations, *supra* note 163, art. 14.

184. *Id.* See also UML, *supra* note 171, art. 15. If the SLAB fails to provide the land, the grantee can rescind the contract and claim liquidated damages. 1990 Grant Regulations, *supra* note 171, art. 15.

185. 1990 Grant Regulations, *supra* note 163, art. 16; UML, *supra* note 171, art. 16. To get the land-use certificate, an application has to be made to the SLAB. UML, *supra* note 171, art. 60 ¶1.

Bureau will issue a premises title certificate.¹⁸⁶ The holder of the land-use rights and the building title holder do not necessarily have to be the same person or entity with this dual registration system. However, this practice may bring problems and therefore it is now expressly stated in the 1990 Grant Regulations that rights to the fixed structures on the land have to follow the land itself.¹⁸⁷

If land development is not started within a year of the launch date specified in the Grant Contract, a fine may be collected from the land-user as a penalty.¹⁸⁸ If the land is still idle after two years, the SLAB has the right to recover the land without compensation. These penalties will not be imposed if the delay is due to force majeure.¹⁸⁹ The threat of penalties is meant to prevent land speculation with idle lots. This regulation is only partly effective. Well-connected developers have been known to get large areas of land granted to them by the SLAB, but have not paid the grant fees. These developers have no capital but will instead pay the city government after selling off the land. This way of doing business is not lawful but is done nonetheless, since there are large sums of money involved.

If a land-user needs to change the purpose of the land-use as specified in the contract, he must obtain permission from the grantor and the city planning department.¹⁹⁰ The state will not recover the land-use right from the land-user before expiration of the term specified in the contract.¹⁹¹ However, the state reserves the right to expropriate the land "under special circumstances and in the light of social and public interests." The land-user will be compensated according to the number of years left on the contract and the extent to which the land has been developed.¹⁹² In reality, this generally phrased provision means that the state can recover land whenever it wants. As the compensation is decided by the government, it tends to be significantly lower than market value.¹⁹³

After the land-use right contract expires, the land with all build-

186. UML, *supra* note 171, art. 60 ¶2.

187. 1990 Grant Regulations, *supra* note 163, art. 23.

188. *Supra* note 171, art. 25.

189. *Id.*

190. *Id.* art. 17.

191. *Id.* art. 19.

192. *Id.*

193. If the land user is not pleased with the compensation, he can sue the government. However, the courts are still under the influence of the state and might or might not be of help. For a closer look at administrative appeal in China, see Geor Hintzen, *Drilling the State: An Introduction to Administrative Law in the P.R.C.*, in ADMINISTRATIVE REFORM IN CHINA SINCE 1978, *supra* note 54 at 1.

ings on it is returned to the State without compensation.¹⁹⁴ If the land user needs to continue using the land, he must apply for an extension no later than one year before the expiration date of the contract.¹⁹⁵ Unless the land needs to be recovered for "social and public" interests, such an application shall be approved.¹⁹⁶

10.3. Allocated Land-Use Rights

Allocated land-use rights are different from granted rights. The government provides the land user with land without consideration.¹⁹⁷ The land-use right normally has no time limit¹⁹⁸ but the land user's rights can be revoked if the state needs the land.¹⁹⁹ In that case, the state needs to compensate the land-user for the structures on the land.²⁰⁰ Furthermore, allocated land may not be transferred without state consent whereas granted land can be freely transferred.²⁰¹

Allocated land is given to state institutions, the military, infrastructure projects and other projects in accordance with law and administrative regulations.²⁰² If, for example, a developer plans to build a toll-road, which is very popular in China today, the developer will try to get allocated land-use rights. Otherwise the cost of acquiring all the land would be prohibitive. However, the toll-road developer will have to pay all fees connected with the resettlement of the people already using the land.

Allocated land-use rights have to be transformed into granted land-use rights before transfer can be made freely.²⁰³ With the approval of the local SLAB and the local Real Estate Bureau, the allocated land-user has to go through the procedures for the land-use grant and pay a grant fee.²⁰⁴ The difference between allocated and granted land has led to much confusion. (See section 10.5 below.)

194. All normal structures are returned with the land. "Non-standard" constructions are often required to be demolished and cleared by the time the land is turned over to the State. See Measures of Shanghai Municipality on the Compensatory Transfer of Land Use Rights, art. 41, Shanghai Municipal People's Gov't (1987).

195. UML, *supra* note 171, art. 21.

196. *Id.*

197. *Id.* art. 22 ¶1.

198. *Id.* art. 22 ¶2.

199. Allocated Land Measures, *supra* note 170, art. 30.

200. *Id.*

201. See Allocated Land Measures, *supra* note 170, arts. 5, 6. See also UML, *supra* note 171, arts. 36-45 (not requiring state consent).

202. *Id.*

203. *Id.* art. 39 ¶1. See also 1990 Grant Regulations, *supra* note 163, art. 45.

204. *Id.*

10.4. Transfer of Land-Use Rights

Granted land-use rights can be sold, inherited, leased or pledged.²⁰⁵ Allocated land-use rights cannot be transferred without the consent of the state.²⁰⁶ Even the transfer of granted land-use rights is restricted. The total amount of the land-use contract fee has to be paid before a transfer is permitted,²⁰⁷ but as mentioned earlier, this in reality is not always followed. At least twenty-five percent of the building has to be finished by the time of a transfer.²⁰⁸ If the projects involve tract land development, land must be ready for industrial use or other construction.²⁰⁹ To transfer real estate, the land-use certificate and the certificate of title to the buildings need to be presented to the SLAB.²¹⁰ Additionally, the parties enter into a transfer contract.²¹¹ All rights to and liabilities from the property are transferred from the seller to the buyer with respect to the new owner's relationship towards the SLAB.²¹² The time limit of the land-use is therefore the remaining time of the period specified in the original Grant Contract.²¹³

In the 1990 Grant Regulations, the state reserved the right to intervene in the real estate market. The local government has a pre-emptive purchase right if the transfer price is "substantially" lower than the market price. When the market price rises irrationally, the local government may take "necessary measures."²¹⁴

Granted land may also be leased to third parties. If a lease for profit is made on allocated land, the profits of the lease must be handed over to the state.²¹⁵ A stamp tax of 0.1 percent of the value of the lease has to be paid by the parties.²¹⁶

Mortgaging is a new way of financing loans in China. Mortgage registration systems have been in effect in the SEZs since the late

205. *See generally* 1990 Grant Regulations, *supra* note 163.

206. Allocated Land-Use Measures, *supra* note 170, art. 5.

207. UML, *supra* note 171, art. 38.

208. UML, *supra* note 171, art. 38(2). More specifically, the regulation stipulates that at least 25 percent of the *investment* has to be done by the time of the transfer, not necessarily 25 percent of the actual building. For all practical purposes, the phrases mean the same thing.

209. *Id.* For commodity housing, other restrictions apply. *See id.* art. 44.

210. *Id.* art. 38.

211. *Id.* art. 40.

212. *Id.* art. 41.

213. *Id.* art. 42.

214. 1990 Grant Regulations, *supra* note 163, art. 26.

215. UML, *supra* note 171, art. 52-55.

216. Provisional Rules of the P.R.C. on Stamp Duty app. 9 5 (promulgated Aug. 6, 1988 by the State Council).

eighties. A national system has been created but it is still in its infancy. The new guarantee (or secured interests) law provides for a national mortgage system,²¹⁷ as does the UML.²¹⁸ Chinese banks provide mortgage loans but most foreign banks are, understandably, still reluctant to accept Chinese mortgages and require other collateral.²¹⁹

When mortgaging real estate, the mortgagor and mortgagee have to enter into a written contract.²²⁰ A stamp tax of 0.5 percent of the value secured by the pledge also has to be paid by the parties.²²¹ All structures on the land are mortgaged along with the land,²²² but buildings added *after* the mortgage is signed are not subject to the mortgage.²²³ This practice differs from the main rule in most Western countries, where all buildings on the land are subject to mortgage, regardless of whether they are built before or after the signing of the mortgage contract. The Chinese have written this rule due to the separate land and premises title certificate system, and thus it is possible to own land but not the buildings. However, unified real estate certificates are allowed under article 62 of the UML. This simplifies the system, and helps avoid the situation where there are different owners for the land and the buildings.²²⁴

According to article 7 of the 1990 Grant Regulations, the land registration system now implemented by the state is required to be open to the public in order to provide creditor safety. The common practice is not to ask to see the books, but to get a certificate from the SLAB that states that as of a certain date there were no mortgages on the land.

217. See Secured Interests Law, *supra* note 146, arts. 33-62.

218. UML, *supra* note 171, arts. 146-51.

219. THE ECONOMIST INTELLIGENCE UNIT, CHINA: INVESTING, LICENSING, AND TRADING REPORT 53 (1994). Chinese bankers are still very cautious about mortgages. To give mortgage loans to private ventures like residential housing or commercial buildings is not considered as risky. The problem is mortgage loans to SOEs when enforcement may be a problem. The bank might not be allowed to put a state company into bankruptcy to sell off the property.

220. UML, *supra* note 171, art. 49.

221. Stamp Duty Rules, *supra* note 217, app. 9 11.

222. 1990 Grant Regulations, *supra* note 163, art. 33.

223. UML, *supra* note 171, art. 51.

224. That a unified land and premises ownership system can be implemented does not necessarily mean that China is moving in that direction. The dual ownership system for buildings and land is a result of the fact that until the late 1980s land-use rights could not be transferred for value, but buildings could. The author has understood that the SLAB wants to unify the ownership, but the construction ministry (*jian she bu*) so far has managed to prevent that.

10.5. Problems with the Land-Use Rights System

The Chinese real estate system is by no means perfect. It is a bridge between socialism and capitalism and was devised as a way of creating a real estate market while retaining the ideologically important state (and collective) ownership of the land. The problem with the system is that it has developed bit by bit and, the rules of the game have changed numerous times. It is natural that a new system needs some time to mature, but many changes affect investor confidence.

The problems include the strange ownership exercised by the collectives, the evasion or disregard for central government regulations by local government and the difference between allocated and granted land-use rights. Until the early 1990s, the collectives often sold off land-use rights (or full ownership to land) to third parties without nationalizing it first. Since the collectives had no power to transfer land, the buyers' title to the land is legally uncertain. Technically speaking, the transfer was void and the land-use right is still held by the collective, but the buildings on the land are still owned by the land user. To get out of this unfortunate situation, the land user needs to get the land granted to him. That means that he might have to pay for the land a second time.

However, the larger problem is the evasion or total disregard by local government on various levels of central government regulations. Local officials have to seek central government approval for large land-use projects, but often evade these rules by breaking up the project on paper or simply ignoring the rules. Another method applied by the local government is to start using the land first and to seek approval afterwards, confronting the SLAB with a *fait accompli*. Local governments without any special authorization have also created their own land-use polices that are not in compliance with national regulation. A buyer of land-use rights, either from local government or from a land-use right holder, has to be very careful and thoroughly check the basis for the rights in question. The central government has made clear that land-use documents illegally approved by a local government will be declared null and void.²²⁵ It is not very likely that the central government will always succeed in enforcing their regulations against the will of local government, but the possibility exists that a land-use grant contract approved by a local government will be declared void by the SLAB.

Even those companies who have all the right approvals from the

225. CHINA DAILY, June 24, 1995.

correct authorities might run into unexpected difficulties. Sino-foreign JVs are experiencing problems dealing with a still-developing land ownership system. The Chinese partner's in-kind contribution to a JV has often been in the form of long-term land-use rights. In the early 1980s the certificates the Chinese partner produced to prove his right to the land were not the kind of land-use certificates issued by SLAB after 1990, but land certificates (*tudizheng*) issued by various government agencies. These could be local government, planning departments, or the department in charge of the Chinese partner. All land contributed to JVs before May 1990 had been allocated land (even though the land might not have been called that at the time).²²⁶

As discussed above, land-use rights may only be transferred if the land has been granted to the transferor. However, it soon became apparent that the contribution of land-use rights into a Sino-foreign JV as an in-kind contribution could constitute a transfer.²²⁷ For a while there was some confusion over whether these regulations applied only to domestic JVs (without any foreign investment) or also to Sino-foreign JVs. The confusion came about because only the domestic JVs (*lianyingqiye*) and not Sino-foreign JVs (*Zhongwai hezi* or *Hezuo qiye*) were mentioned in the regulation.²²⁸ Until mid-1994, the SLAB interpreted the measure so that the Sino-foreign JV land-use rights were not affected. After that date, however, the SLAB stated that land-use rights may only be contributed to a JV if the land-use rights have been granted to the Chinese partner in a Sino-foreign JV.²²⁹

This means that JVs who received allocated land contributed to them after May 1990 did not have the right to the land. JVs who received land contributed before that time have a valid legal right, since the regulations did not exist at the time the JV received the land. In both cases, the result is the same. The SLAB wants the JVs to pay for the proper, granted land-use rights. The amount of the grant fee will be determined after formal appraisal by a licensed appraisal agency. For JVs established before the existence of the current grant system, this is a *post facto* payment that might bring large unexpected costs. From the SLAB's point of view, it is a question of enforcing the law and forcing offenders to pay for the land they are using. Furthermore, the SLAB wants to bring all different 1980s land-use right constructions in line with the post-1990 system.

226. Nicholas C. Howson, *On Shaky Ground: Land Use Rights contributed to JVs*, EAST ASIAN EXECUTIVE REPORTS, Dec. 15, 1994, at 11.

227. *Id.*

228. *Supra* note 170, art. 40.

229. Howson, *supra* note 227, at 11.

The SLAB has made it clear that the fee for such *post facto* payments might be eased somewhat by either extending the payment period or assigning some of the value of the granted rights to entities representing the state, thus creating new partners in the joint venture. The SLAB has indicated that the fees owed it might be reduced or exempted upon individual application.²³⁰ Those companies who do not comply with this dictate from the Chinese state are taking big risks.

The first risk is that the land-use rights might be seized with only minimum compensation. This is *perhaps* what happened in the famous case with the Wangfujing Street McDonald's franchise. McDonald's had entered into a JV with the state-owned Beijing General Cooperation of Agriculture, Industry and Commerce. The Chinese partner contributed land-use rights for 20 years to a prime spot on Beijing's busiest business street. The contract was signed in 1989, and in 1992 the first McDonald's on mainland China opened. In late 1994, McDonald's was ordered by the local government to vacate the lot to make room for a new giant shopping and office complex called the Oriental Plaza. As compensated, McDonald's would get a slot inside the big plaza. McDonald's objected because this outlet was very profitable and they did not want to close for 18 months for construction of the complex. McDonald's told the press. In the international media, McDonald's was portrayed as a victim and the impression was made that McDonald's had a solid right to the spot on Wangfujing Street.²³¹

From a Chinese legal standpoint, McDonald's probably did not have that solid of a right. Whether land-use rights were contributed to the JV or leased to it, they most likely were not "granted" or subject to a land grant contract. Thus, since the land had been transferred to the JV without remedial payment to the SLAB by the holder of the land-use rights, the land-use rights were revocable. The Beijing municipal government needed to do little more than to withdraw the permission to use the allocated land that formed the basis of McDonald's hold on the underlying site.²³²

230. *Id.* at 12.

231. Bruce Gilley, *Tower of Power: Beijing's Oriental Plaza Rises from the Ashes*, FAR EASTERN ECONOMIC REVIEW, Feb. 15, 1996, at 44.

232. Howson, *supra* note 230, at 12. That the government had support in law to remove McDonald's from the site might be true technically, but one wonders what assurances the city had given McDonald's before and what moral right the city had to remove the hamburger vendor. In the end, it seems that Ronald McDonald got the last laugh. Construction of the Oriental Plaza was halted for many months and China lost investor confidence due to McDonald's clever handling of the press. The matter is settled and McDonald's is rumored to have been given compensation for vacating the lot. See also Gilley, *supra* note 232.

A second risk is that given the unsure status of the land, nobody will be willing to buy it. Transfer of land might not be possible, which is of crucial importance to real estate developers who may not be able to lease or sell real estate erected on such land. Another option denied these JVs is finance by mortgage, as banks are not likely to accept mortgages on land with unsure title.²³³

The third and perhaps most likely risk with non-compliance is that the JV has to pay the full grant amount or suddenly be forced to accept a new partner, who represents the state's interests in the revalued equity.²³⁴

11. Rural Land

11.1. 1949-78

On China's rural land live some 900 million people. The exodus of rural population to the cities that normally characterizes an industrializing nation has only marginally occurred in China.²³⁵ The control mechanisms that restricted movement of peasants are a lot weaker today than they used to be and migration to the cities is increasing. An estimated 100 million people are regarded as "floating population" in China, but the pressure on the cities seen today is nothing compared to the numbers that will begin to move if the rural policies of the government are unsuccessful.

The CCP's rural policy has always focused on increasing agricultural production. However, before 1978, the measures taken often ranged from bad to disastrous. The post-1949 land reform that gave farmers individual ownership was merely a first step in the lengthy process of increasing agricultural output. In 1955, to raise crop-yields and to facilitate central planning, the rural land was re-organized into collectives at the village level. The Chinese leaders called this new system "peasant land ownership." Instead of individual ownership, farmers collectively got a proprietary right to the produce of the land. However, the peasant households were each allowed to keep a small private lot.²³⁶

233. Howson, *supra* note 227, at 12. The banks, not surprisingly, have been hurt financially as a result of accepting land with unclear title and they are not likely to repeat their mistakes.

234. *Id.*

235. As will be noted below, the collectives have exercised such power over the movement of the peasants that at least until the early 1980s it was very difficult for them to leave their birth site.

236. Ralph H. Folsom, *LAW AND POLITICS IN THE PEOPLE'S REPUBLIC OF CHINA* 252 (1992).

Following the 1958-60 Great Leap Forward disaster and up to the early 1980s, the collective agriculture was organized in communes of 4,000-5,000 peasant households. The commune system was based on a three-level system with ownership rights divided between the three primary collective units: the commune, the brigade (usually a natural village) and the team. The team, typically comprising thirty to forty households, was the primary ownership, accounting and management unit. The power to exercise ownership rights was essentially restricted to organizing cultivation of the land according to state directives.²³⁷ Transfer rights, crop choice and crop sale prices were all controlled by the state. The restrictions applied even to the small private lots. The integration of peasants and land was so tight that it can almost be said that the land owned the people. The collectives exercised tight control over the workforce and the residents were legally bound to the land, since they were barred from migrating elsewhere and were obliged to work for the collective.²³⁸

The commune system was not popular among the peasants, who were forced to work and live in poverty in massive rural labor camps. For anybody not of the same high caliber as Lei Feng,²³⁹ motivation was low. Thus, in spite of the large scale farming, agricultural output was so low that one in five Chinese suffered malnutrition.²⁴⁰

11.2. The Household Responsibility System

The land-use system was fundamentally transformed between 1978-80. A "household responsibility system" was introduced, which meant that land was contracted out to peasant households. The farmers had to sell a quota of basic crops to the state at fixed prices but any surplus could be sold to whomever else they wanted, at market prices. As the system's designers had intended, agricultural output grew immensely in just a few years. Land was initially only contracted out for three years but since the farmers then were found to be unwilling to invest in agriculture, in 1984 the Central Committee extended the terms to 15 years and allowed inheritance of the land for the duration

237. Selden & Lu, *supra* note 158, at 188.

238. *Id.* at 190.

239. Lei Feng, a communist propaganda character, was a model soldier who devoted his life to work for society. Even today, the CCP insists that he was a real character and promotes him as an example for a morally degenerating society. See JONATHAN D. SPENCE, *THE SEARCH FOR MODERN CHINA* 597-98 (1990). See also JUNG CHANG, *WILD SWANS* 256-58 (1991).

240. TIME (ASIA EDITION), May 15, 1995.

of the contract.²⁴¹ As of September 1995, most of these contracts are expiring and can now be renewed for another 30 years.²⁴² Today, the farmers do not only have land-use rights but they may, under certain conditions, also transfer the land to another household for the duration of the contract. However, the state retains the right of eminent domain. The state may take possession of the contracted land if it pays compensation.²⁴³

Up until the mid 1980s, there were no laws dealing with land-use administration. As a result, many contradictory land policies were issued by different sections of the government. Land disputes were common, and farmers in charge of the partial property rights illegally sold, rented or mortgaged their land. In 1986, the Land Administration Law was passed and since then, land ownership and occupation have been based on law.²⁴⁴ However, the property system is still unclear. After communes were abolished, ownership was supposed to be vested in the villages, but under the LAL, larger groups suspiciously similar to the old communes may still own land.²⁴⁵ To avoid ambiguity and subsequent disputes, title to land is supposed to be registered with the government at the county level.²⁴⁶

But as with the urban land-use system, the rural household responsibility system is far from perfect. It is more successful than Mao's People's Communes, but the current contract system is not especially efficient either. For one thing, the plots are too small. Since a scientific evaluation of the land has not been feasible, every family has to have about the same proportion of each land quality type.²⁴⁷ This means that each farmer gets different small patches spread out all over the village land, instead of one heterogeneous large plot. This system is more reminiscent of European farming administration of the medieval age than

241. Selden, Mark & Lu, *supra* note 158, at 193.

242. CHINA DAILY, June 15, 1995.

243. Selden & Lu, *supra* note 158, at 195. Investments done on the land by the peasant must also be compensated. The value the state is supposed to pay is regulated by LAL art. 28. (See LAL, *supra* note 162). It states that the compensation should be three to six times the average annual output of the land in the last three years, plus payment of a subsidy for rural people who are displaced. This "value" has little to do with market value and the state has problems enforcing these guidelines. See Selden & Lu, *supra* note 158, at 198.

244. LAL, *supra* note 162.

245. *Id.* art. 8 (allowing land ownership by "two or more collective economic entities").

246. *Id.* art. 9.

247. Qu, Futian *et. al.*, *Land Administration in China's Rural Area: Reform and Its Impact*, in ADMINISTRATIVE REFORM IN CHINA SINCE 1978, *supra* note 54, at 128.

of the 20th century. The best way to deal with this problem may be to allow transfer of land use rights more freely so that all production resources will be distributed efficiently.²⁴⁸ This would be made possible by giving the farmers a land-use right to farmland similar to the land-use system used on urban land.²⁴⁹

The state is aware of this problem but is reluctant to impose changes that would make many peasants redundant. In the long run, the government may have no choice but to reform the land management system. The state has lost control to some extent over rural land development. Much arable land is taken every year for housing and industry development. Moreover, the practice of building tombs to testify to family status is once again becoming popular,²⁵⁰ occupying yet more land. Another serious problem is the large scale soil erosion. These factors taken together mean that China is losing much arable land even as the 1.2 billion population continues to increase by 14 million people annually.²⁵¹

VI. CONCLUSION

Since the beginning of reform in 1978, Chinese society has undergone tremendous changes. In the mid-1970s, there was no real need for an advanced property law in China since all companies and all land were owned or *de facto* controlled by the state. However, in the last fifteen years, China has made rapid economic advancements and property ownership has been diversified. Average incomes have tripled, private enterprise is allowed and new venture capital can be raised through stock markets. The farmers have a land-use right to the land they cultivate and urban land can be transferred for value.

With the demands of an advanced market economy, it may only be a few years before China has established modern economic legislation, including an advanced property law bearing great resemblance to Western law. The momentum for legal reform is strong in the PRC today, and many important laws are being passed every year. Compared to other emerging markets, the legal reform in China has been quick.

248. CHINA DAILY, June 15, 1995.

249. To give farmers a better land-use right than the current contract system allows is proposed by the study group drafting the Chinese Property Law. See FAXUE YANJIU, *supra* note 102, at 9.

250. It is forbidden to put graves on arable land. Disregard of this rule could mean severe punishment during the Mao era, but today this rule is widely ignored. TIME (ASIA EDITION), May 15, 1995.

251. CHINA DAILY, June 24, 1995.

However, protection of property rights is another matter altogether. The legal system is still weak in China and there exists no true rule of law. As long as the CCP holds absolute power, the courts will never be strong, independent organs. Regional protectionism makes it difficult to enforce a claim from another part of the country. In the metropolitan areas of Beijing, Shanghai and Guangzhou (Canton), the enforcement of property rights will work better than in the interior regions. Even in these cities, the function of property law will not be comparable to Western standards in the foreseeable future. Protection of property rights will slowly be strengthened, but the PRC still has a long way to go before actual possession without title is a *de facto* weaker right than having the title to the property but no possession.