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## Changing Patterns of Ownership Rights in the People's Republic of China: A Legal and Economic Analysis in the Context of Economic Reforms and Social Conditions

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## Changing Patterns of Ownership Rights in the People's Republic of China: A Legal and Economic Analysis in the Context of Economic Reforms and Social Conditions

*Paul Cantor\**  
*James Kraus\*\**

### ABSTRACT

*This Article analyzes the legal and economic effects of privatization and the changing patterns of ownership rights in the People's Republic of China. After an overview of Chinese concepts of property rights, the authors discuss the history of China's post-liberation nationalization process and the movement back toward privatization and decentralization. Privatization has led Chinese law toward the recognition of private rights and duties in property law matters. The authors examine China's basis for altering ownership rights and moving in the direction of a market-oriented economy. The Constitution of the People's Republic of China and Chinese statutes contain specific language delineating domestic own-*

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ership rights and protection of foreign investment in China. Despite China's expanding constitutional and statutory protection of private property ownership rights, the authors state that the Chinese legal system still lacks international and domestic credibility.

The authors evaluate the socioeconomic impact of the rapid emergence of private ownership in China. For the average Chinese citizen, the authors believe the expansion of property rights and freedom of choice has brought forth insecurity, uncertainty, unfamiliar financial burdens, inflation, a relative abundance of consumer goods, and broad questions concerning the future of Chinese socialism, socialist ideals, and the usefulness of supporting collective action in Chinese society. The authors compare similar privatization practices in Chile and the Soviet Union to contrast these states' economic growth rates and experiences with those in China. The authors also assess the results of China's experiment with ownership rights, using comparative lessons from Chile and the Soviet Union as the basis for predicting the outcome of China's effort at transformation. The authors conclude that China will be compelled, perhaps through the threat of social unrest caused by growing income inequality and loss of social welfare benefits, to move more slowly towards privatization and freer markets.

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#### I. INTRODUCTION

Over the forty years of its existence, the People's Republic of China has made the transition from full scale nationalization to widespread privatization.<sup>1</sup> This privatization process stems from China's attempts to

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1. Nationalization was part of China's post-liberation economic policy. See *infra* notes 11-19 and accompanying text. It was also one aspect of its foreign policy. For example, when the United States froze \$80.5 million of Chinese assets after China's

shift from a centralized command economy, which has depended almost exclusively on domestic reinvestment of capital, restrictive employment practices, controlled stable prices, and homegrown technology.<sup>2</sup> Since 1979, in a dramatic reversal of economic policy, China has been shifting ownership rights of industrial, agricultural, and individually held real and personal property from the state to the private sector. China has been opening its markets and borders to the outside world in an effort to expand international trade and attract foreign capital and technology.<sup>3</sup> It

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intervention in the Korean War, China retaliated in part by nationalizing approximately \$197 million of United States nationals' property in China. See Comment, *United States Policy Regarding Nationalization of American Investments: The People's Republic of China's Nationalization Decree of 1950*, 14 CAL. W. INT'L L.J. 148, 148 (1984). After China imposed control over the assets on December 28, 1950, they were transferred to national and regional government agencies. *Id.* at 148 n.2. Claims for compensation and the political ramifications of this dispute were finally resolved on May 11, 1979, by a lump-sum payment to United States claimants of 41% of certified claims for the property nationalized. *Id.* at 149. The timing of this settlement is only one aspect of China's changing policy of opening to the outside world and its decision to establish improved relations with the United States.

2. Chinese leaders freely acknowledge that state ownership and centralized management are no longer essential or exclusive economic models. In 1987, Premier Zhao Ziyang predicted that "[o]nly about 30 per cent of China's entire economy will be controlled through central planning in two or three years as China gradually moves from a highly-centralized planned economy to a planned commodity economy." *China Daily*, Oct. 30, 1987, at 1, col. 1. For instance, Chen Hongchang, Mayor of Changzhou, has said that "the essence of China's economic reform involves reducing excessive public ownership and changing overcentralized management, so as to make them suitable to China's present productive forces. This reform, he said, however, will not lead to capitalism, or a mixed socialist-capitalist economy." *Reducing Public Ownership*, in *PROGRESS IN URBAN REFORM* 26, 27 (1986).

Regardless of the political climate in China, these steps may not be adequate to ensure needed levels of foreign investment.

According to surveys outside China, foreign investors generally consider a range of factors, including political stability, legal standards, quality of workforce, the freedom to hire and fire, and market opportunities, before making a decision to invest. Tax incentives are only one among these and other considerations.

Now more than ever, Peking regards foreign capital as essential to its modernisation drive and appears willing to bend over backwards to accommodate investors. This has been evident in the vast number of laws passed recently to give investors a legal framework in which to operate.

Cheng, *Despite Changes, Funds Fail to Flow Freely*, *FAR E. ECON. REV.*, Mar. 24, 1988, at 77, 78. Chen Pixian, Vice-Chairman of the Sixth National People's Congress Standing Committee, recently reported that, of the 37 laws enacted by the Sixth National People's Congress, 22 govern economic activities and 10 concern China's opening to the outside world. *China Daily*, Apr. 2, 1988, at 4, col. 1.

3. In the past, China had isolated itself economically from foreign influence. See *in-*

has been exploring more flexible forms of employment to stimulate flagging worker productivity, reduce underemployment, expand employment opportunities, and invigorate stagnant agricultural output. The Chinese

*fra* note 7 and accompanying text. Recent policy is a marked departure from this and is acknowledged as a quick means to develop the economy. See Mu, *New Developments in China's Economic Legislation*, 22 COLUM. J. TRANSNAT'L L. 61, 63 (1983). This article contains a brief description of the legislation that has been passed to encourage reliance on the Chinese legal system in business matters and stimulate foreign investment. *Id.* at 68-76.

China's encouragement of foreign investment has been amply documented. "Gu said that China was the only country in the world, which had written into its Constitution that foreigners were allowed to invest in joint venture enterprises. This emphasized the country's wish to open to the outside world." Statement of Gu Ming, Chief of the State Council's Economic Legislation Research Center, *quoted in China Daily*, Oct. 19, 1985, at 1, col. 2.

The Constitution of the People's Republic of China states:

The People's Republic of China permits foreign enterprises, other foreign economic organizations and individual foreigners to invest in China and to enter into various forms of economic co-operation with Chinese enterprises and other economic organizations in accordance with the law of the People's Republic of China.

All foreign enterprises and other foreign economic organizations in China, as well as joint ventures with Chinese and foreign investment located in China, shall abide by the law of the People's Republic of China. Their lawful rights and interests are protected by the law of the People's Republic of China.

PRC CONST. art. 18.

The most extensive list of Chinese legislation in the commercial areas can be found in M. MOSER, *FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA* 581-99 Appendix, Table of Legislation (2d ed. 1987).

See also *List of Foreign Economic Regulations of the PRC, 1986*, INTERTRADE, Mar. 1987, at 54-55. Keeping abreast of the latest count of new laws is a popular pastime. "Over the past five years, the Sixth National People's Congress and its standing committee adopted 35 laws, 11 decisions on law revision and 17 decisions on other matters of law. *China Daily*, Mar. 11, 1987, at 3, col. 2. "The State Council issued and approved 76 administrative regulations last year, of which 15 concerned Sino-foreign economic activities, according to Sun Wanzhong, director of the legal affairs bureau of the State Council." *China Daily*, Jan. 29, 1988, at 1, col. 7. "The State Council plans to act on 37 drafts of laws and 176 sets or administrative regulations this year. *China Daily*, Mar. 24, 1988, at 1, col. 1. Li Peng said that:

gradual progress was made in the building of a socialist legal system. Over the past five years, 30 laws were submitted by the State Council to the Standing Committee of the National People's Congress for examination and approval, and 255 administrative statutes [sic] were formulated and promulgated by the State Council.

*China Daily*, Mar. 26, 1988, at 4, col. 4.

For a broad discussion of the relationship of political, social and economic factors to the development of recent Chinese law and an introduction to specific economic and commercial laws, see P. CHAN, *PEOPLE'S REPUBLIC OF CHINA: MODERNISATION AND LEGAL DEVELOPMENT* (1983).

also have been experimenting with changing patterns of ownership to revitalize its declining housing stock. To bolster economic growth, China is relying increasingly upon private ownership, free markets, currency reform, floating prices, and worker mobility.

This Article examines the legal and economic effects of privatization and changing forms of ownership rights in China, their relationship to current economic reform, their impact on the Chinese people, and China's likelihood of success in view of similar privatization efforts in other socialist nations. This Article discusses the history of China's post-liberation nationalization process and the movement back to privatization and decentralization and their influence on current law and policies. The Article then analyzes changes in Chinese law and the institutional legal structure that underlies and fosters this transformation. The Article then evaluates the socioeconomic reactions to these changes and the corresponding impact on the Chinese people. Finally, the Article examines privatization practices in Chile and the Soviet Union for the purposes of contrasting these states' economic growth rates and experiences with those in China. The Article concludes by assessing the results of China's experiment with ownership rights, stressing comparative lessons from these other states as the basis for predicting the outcome of China's effort at transformation.

## II. HISTORICAL BACKGROUND

For centuries, Chinese concepts of property rights were rooted in strongly autocratic Confucian doctrine that enshrined and vindicated hierarchy, authority, and inequality.<sup>4</sup> In China's largely agrarian society, real property was vested in a small landowning class, while power over personal property, in accordance to the familial relationship venerated by Confucian thought, remained subject to the immediate control and disposition of the male head of household and passed through the patriarchal line at death.<sup>5</sup> Confucian doctrines of filiality took precedence over West-

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4. See H. KIM, *FUNDAMENTAL LEGAL CONCEPTS OF CHINA AND THE WEST* 11-17 (1981).

[T]he written law of pre-modern China was overwhelmingly penal in emphasis . . . [and] it was limited in scope to being primarily a legal codification of the ethical norms long dominant in Chinese society. . . . The penal emphasis of such law, for example, meant that matters of a civil nature were either ignored by it entirely (e.g., contracts), or were given only limited treatment within its penal format (e.g., property rights, inheritance, marriage).

Boddie, *Basic Concepts of Chinese Law*, 107 *PROC. OF THE AM. PHILOSOPHICAL SOC'Y* 375 (1963).

5. Even during the Nationalist period, when the inheritance law was changed to

ern concepts of right and duty while law-oriented culture was subrogated to concepts of personal relationships and moral duties.<sup>6</sup>

Although ancient China was receptive to foreigners and extended civil rights to aliens, this practice ended at the beginning of the Ming Dynasty in 1644, when China intentionally sought to isolate itself from Western influence and placed numerous restrictions on Westerners within its borders.<sup>7</sup> This period of isolation continued until the second half of the nineteenth century when China's exposure to Western concepts of property law expanded as foreign domination imposed, often upon an unwilling and unknowledgeable population, the basics of West-

provide for equality of the sexes and to entitle all of a deceased's children to equal shares of his property, tradition prevailed and everything passed from a deceased father to the oldest son of the legitimate wife. Lee & Lai, *The Chinese Conceptions of Law: Confucian, Legalist, and Buddhist*, 29 HASTINGS L.J. 1307, 1325 (1978).

6. Confucian ideology often has been ascribed as a reinforcing role inhibiting industrial innovation and thereby maintaining the Chinese hierarchical society of interpersonal and property relationships.

[T]he officials adopted the Confucianist doctrine as being the ideology that best expressed their way of life, since, in spite of preaching respect for others, justice and reciprocity, these virtues were reserved for relations between educated people, whereas for the ordinary subject, the cardinal virtue was absolute obedience. Its unalterable aim was to maintain the status quo of the social hierarchy. . . .

Respectfulness, humility, deference, docility, complete submission and subordination to elders and betters—these were the dominant features of the Confucian ethic that helped to cement the hierarchy, creating a patriarchal, paternalistic world in which gradations of rank, from the sovereign downward, were marked by the reciprocal relations of favor and obligation, and individual rights, initiative, and liberty were entirely lacking.

E. BALAZS, CHINESE CIVILIZATION AND BUREAUCRACY 155 (1964).

For a contemporary Chinese theoretical study that offers possible models of combinations of Confucian ethics of filial piety and modern Western family ethics of right and duty applicable to China's emerging industrial society, see Cheng, *On Confucian Filial Piety and Its Modernization: Duties, Rights, and Moral Conduct (Lun Rujia xiaode lunli jiqi xiandaihua: zeren, quanli, yu dexing, Hanxue yanjiu)* 4 CHINESE STUDIES 1 (June 1985), reprinted in 20 CHINESE STUD. PHILOSOPHY 48 (Winter 1988-89).

7. Between the period from 221 to 206 B.C.E., when the Emperor Qin Shihuang unified China, until the Ming Dynasty (1368-1644 C.E.), China generally was open to foreigners and extended them civil rights. See YAO DAZHONG, ZHONG GUO SHI JIE DE QUAN SENG (THE FLOURISHING PERIOD OF THE WORLD OF CHINA) 155-65 (1983). The Chinese regarded China as the whole world (Tian Xia). The man who was counsel to Tian Xia, the Emperor, was called the Son of Heaven. See SELECTIONS OF MATERIALS OF CHINESE PHILOSOPHY HISTORY (Han Dynasty Volume) at 43-48. In the Ch'ing dynasty, Chinese emperors took the same attitude toward modern foreign countries that sought to establish relationships with China as they previously had taken toward vassal states within the territory of China. This included restrictions on aliens. See 1 J. COHEN & H. CHIU, PEOPLE'S CHINA AND INTERNATIONAL LAW 506-07 (1974).

ern international law.<sup>8</sup>

Wealth continued to be highly concentrated well into the twentieth century, and millions of Chinese remained subjected to the whims of landlords who held agricultural lands and leased their use to the peasants.<sup>9</sup> In 1949, China remained predominantly rural and agricultural, with close to 90 percent of its population living in the countryside and approximately 65 percent of the national income generated by the agricultural sector.<sup>10</sup>

Ownership rights changed significantly after liberation. The establishment of the People's Republic of China brought forth an intensive policy of nationalization of both agricultural land and industrial property.<sup>11</sup> The government expropriated land from landlords, without compensation, and redistributed it to the formerly landless peasants.<sup>12</sup> Between 1949 and 1952, the Chinese government transferred 44 percent of China's land through this process of land reform.<sup>13</sup> Industrial property,

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8. Cohen, *Sino-American Relations and International Law*, in DRAGON AND EAGLE 331, 334 (1978). "The advent of the treaty system made inevitable China's sustained exposure to and gradual assimilation of Western international law." T. WANG, *INTERNATIONAL LAW* 17-18 (1982).

9. For accounts of Chinese rural poverty in the first half of the twentieth century, see H. CHEN, *LANDLORD AND PEASANT IN CHINA* (1973); J. MYRDAL, *REPORT FROM A CHINESE VILLAGE* (1965); C. YANG, *CHINESE COMMUNIST SOCIETY THE FAMILY AND THE VILLAGE* (1965). By the eighteenth century, absentee ownership had increased and numerous landlords moved to urban areas and provincial towns. J. FAIRBANK, *THE UNITED STATES AND CHINA* 27 (3d ed. 1971). By 1937, taxes in Szechuan had been collected 60 years or more in advance and farmers, unable to pay rents and outrageous loan interest, abandoned their land. E. SNOW, *RED STAR OVER CHINA* 83-84 (1961).

10. T. LIU & K. YEH, *THE ECONOMY OF THE CHINESE MAINLAND NATIONAL INCOME AND ECONOMIC DEVELOPMENT, 1933-1959*, at 66, 212 (1965).

11. Prior to 1949 there had been some expropriation and redistribution of land in areas under the control of the Red Army, but this was limited to areas under their control. This campaign came to fruition after liberation when the new Chinese government made the working class the leaders of the republic and quickly embarked on a program to strengthen the nation, which was articulated in the "Common Program of the Chinese People's Political Consultative Convention," enacted in September 1949. See *The Law and Regulations Used for Law Teaching*, FUDAN U. L. DEP'T, Mar. 1984, at 31; J. FAIRBANK, *THE UNITED STATES AND CHINA* 362-63 (4th ed. 1983).

12. For detailed accounts of this land reform process, see W. HINTON, *FANSHEN: A DOCUMENTARY OF REVOLUTION IN A CHINESE VILLAGE* (1966); D. CROOK & I. CROOK, *REVOLUTION IN A CHINESE VILLAGE, TEN MILE INN* (1959).

13. V. LIPPIT, *LAND REFORM AND ECONOMIC DEVELOPMENT IN CHINA* 95 (1974). Mao Tse-tung made agrarian land reform the primary task. This concern came partially from Mao's first hand knowledge of the distribution of land ownership. E. SNOW, *supra* note 9, at 162. In 1926, Mao was a Kuomintang secretary and supervised the collection of land statistics for areas in 21 provinces. Mao's investigations disclosed

mostly urban, was nationalized and many former landowners fled China, underwent re-education, or otherwise were eliminated.<sup>14</sup> The state sector's share of the economy jumped from 34.7 percent of the total industrial output value in 1949 to 56 percent of the gross industrial output value in 1952.<sup>15</sup> By 1952, an additional 26.7 percent of gross industrial output was produced according to state orders. At the same time, production by independent private enterprises had declined to 17 percent, down from the 1949 total of 63.3 percent.<sup>16</sup> The state's role in wholesale trade stood at 63.7 percent.<sup>17</sup> By 1956, this nationalization process essentially was complete: 67.5 percent of gross industrial output value emanated from state-owned firms, and 32.5 percent from joint state-private firms, while 97.2 percent of wholesale trade and 95.2 percent of retail trade was the product of state and joint state-private firms.<sup>18</sup>

Superseding versions of the Chinese Constitution vested ownership of land in the state for use by the people.<sup>19</sup> State ownership of these enterprises provided the government with a conduit for controlling workers through work units. Employment, job mobility, urban residential hous-

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that resident landlords, rich peasants, officials, absentee landlords and usurers, about 10% of the whole rural population, together owned over 70% of the cultivable land in China. Over 65% of the rural population, made up of poor peasants, tenants, and farm workers, owned only from 10% to 15% of the total arable land. *Id.* at 84-85.

14. One commentator has described this process as follows:

In China proper the new government established its control with great rapidity. At the beginning hundreds of thousands of the youth in middle schools and colleges were hurriedly trained for bureaucratic posts, and a major part of those in office submitted to 'reorientation' and were reassigned. From the reports that are available such complaints as graft, nepotism, and injustice leveled against office holders seldom apply; the new philosophy of government requiring fairness above all to peasants and workers seems to have been instilled with remarkable success. Any accused of landlordism, however, were liquidated. No one knows how many suffered the extreme penalty for this cause; the total may run into the millions. Justice is summary.

L. GOODRICH, *A SHORT HISTORY OF THE CHINESE PEOPLE* 241 (3d ed. 1959). Beginning in 1956, during the First Five-Year Plan, 1953-57, the government paid fixed dividends of 5% to the former owners of private enterprises and allowed some of them to retain managerial and technical positions within the firms. The payments were terminated in 1967. M. XUE, *CHINA'S SOCIALIST ECONOMY* 31 (1981).

15. *Id.* at 19, 22.

16. *Id.*

17. *Id.* at 23.

18. *Id.* at 31.

19. Succeeding constitutions were promulgated in 1954, 1975, 1978, and 1982. Tay & Kamenka, *Law, Legal Theory and Legal Education in the People's Republic of China*, 7 N.Y.L. SCH. J. INT'L & COMP. L. 1, 10, 18, 23, 25 (1986). See *infra* text accompanying notes 63-64.

ing, social welfare entitlement programs, ration coupons, and political education all became the domain of the urban work unit. Public education, by right, became the norm beginning with the work unit nursery schools, through children's palaces for talented prodigies in the arts, athletics and sciences, and along with publicly provided education from primary school through advanced university degree programs. By 1953, Chinese law required such social welfare benefits as workmen's compensation and pensions.<sup>20</sup> By 1965, China could boast that ordinary workers and staff members received 60 percent to 75 percent of their regular wages when in retirement.<sup>21</sup>

Collectivization of agriculture began in full force in 1958. In 1957, when the commune and collective movement began in earnest, individual families operated 82 percent of Chinese agricultural enterprises.<sup>22</sup> By 1959, 73 percent of Chinese agriculture consisted of large communes and state farms, some with work brigades exceeding 70,000.<sup>23</sup> During the Great Leap Forward, an era characterized in part by the proliferation of backyard industry, enterprises generally decreased in size.<sup>24</sup> Agricultural

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20. Since 1953, the Labor Insurance Regulations of China have required that enterprises with workforces of at least 100 workers provide retirement, medical, unemployment, and industrial injury benefits. China Daily, Aug. 5, 1989, at 1, col. 1. Free medical care and workers' compensation are required. Carl, *Contemporary Law in the People's Republic of China*, 32 Sw. L.J. 1255, 1266 (1979).

21. Zheng, *Employment, Wages, Workers' Welfare and Labor Protection in China*, in 1981 ALMANAC OF CHINA'S ECONOMY 702 (M. Xue ed. 1982).

22. See V. LIPPIT, *supra* note 13, at 172.

23. Statistics on agricultural production indicate that after the formation of the communes agricultural production began to fall. Taking 1957 grain production as a 100, the index rose to 103 in 1958 but then fell to 83 in 1959, 67 in 1960, and stabilized at 69 in 1961. It was not until 1965 that grain production per capita regained 1957 levels. JOINT ECON. COMM., 97TH CONG., 2D SESS., CHINA UNDER THE FOUR MODERNIZATIONS PART I, at 104 (Comm. Print 1982) [hereinafter JOINT ECON. COMM.].

This was followed by a movement towards mutual aid teams whereby groups of families would work land mutually. By 1954, 58% of China's farm households had joined mutual aid teams. Selden, *Cooperation and Conflict: Cooperative and Collective Formation in China's Countryside*, in THE TRANSITION TO SOCIALISM IN CHINA 52 (1982). The full movement to communes began in the summer of 1958, reaching a peak of 98% membership by the end of the summer. Not surprisingly, this rapid movement has foreshadowed many of the problems of later rapid structural changes in the Chinese economy. Adjustment time was extremely limited and the overnight transition from single family economic units to massive communal enterprise required skills in recordkeeping, accounting, distribution, and some method to maintain material incentives to promote productivity. See V. LIPPIT, *supra* note 13, at 172.

24. During the Great Leap Forward, although small-scale backyard industry was unsuccessful, overall industrial production did increase, rising from an index of 100 in 1957 to 181 in 1960. But it fell from 1961-62, partially because of the pullout of Soviet

markets remained state controlled and operated, with the state, as the sole customer, purchasing agricultural products and re-selling them in urban areas at nationally set prices. The state executed these policies largely by administrative fiat.<sup>25</sup> Laws were few and the state rarely made public or strictly followed its administrative regulations. Between 1949 and 1979, implementation of China's few formal laws was more a matter of Communist Party policy and will than any attempt at a consistent application of legal principles.<sup>26</sup>

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advisers in the summer of 1960. It did not reach its pre-pullout level until 1965, at which time it reached an index of 199. See JOINT ECON. COMM., *supra* note 23, at 104.

25. See Tay & Kamenka, *supra* note 19, at 17.

26. There is some dispute about the extent of codification and publication of laws in China during the period following liberation. According to one periodical:

From 1949 to 1979, the PRC did not promulgate any legal codes, not even a criminal statute for ordinary crimes, even though China's socialist legal system, as a branch of the civil law system, might be expected to have all the major law codes. Most laws and regulations enacted prior to the Cultural Revolution in 1966 were "administrative laws and regulations" [xingzheng fagui] that covered such areas as transportation, education, finance, and the like. Two compendia containing the texts of this legislation were published. The first, *Collection of Laws and Decrees of the Central People's Government* [Xhongyang Renmin Zhengfu faling huiblan], covers the years 1949 to 1954, prior to the promulgation of the first Constitution of the PRC in September 1954. This collection appeared in five volumes, published from 1952 to 1955. The second compendium, *Collection of Laws and Regulations of the People's Republic of China*, [Zhonghua Renmin Gongheguo fagui huibian], covers the years 1954-1963. It appears in 13 Volumes that were published from 1956 to 1964.

Hsia & Zeldin, *Legislation and Legal Publication in the PRC*, CHINA EXCHANGE NEWS, Sept. - Dec. 1987, at 13, 14.

Others, however, note that:

Between 1949 and 1965, a number of "model" laws, such as the Marriage Law, the Law of Land Reform, the Regulations on Punishment of Counterrevolutionaries, Regulations on Penalties for Corruption, the Law of Agricultural Tax and the Law of Industrial and Commercial Tax, were promulgated. There was, throughout that period, no general civil or criminal code of law, no law of civil or criminal procedure and no commercial code. Of course, there were discrete regulations, instructions and directives, many of them not published. Altogether, according to the Chinese Official Yearbook for 1983/84 some 1,500 statutes were proclaimed in the period from 1949 to 1965 by China's state organs, including ministries directly under the State Council which constitutes China's Government. Between 1958 and 1975, the 1954 Constitution was neither repealed nor observed in practice or in theory. Rather, it was simply ignored.

Tay & Kamenka, *supra* note 19, at 17 (footnotes omitted).

The study of law was confined largely to public international law and was under the domination of university international politics departments. See *id.* at 10-12, 17. They conclude that, although China's first national Constitution in 1954 ostensibly recognized

In 1978, however, a dramatic shift in policy and property ownership rights took place at the Third Plenary Session of the Communist Party's Eleventh Central Committee, when reformers gained control of the Communist Party.<sup>27</sup> This marked the start of the privatization movement and the re-emergence of forms of private property ownership.

China moved to a national policy that de-emphasized central planning. The state replaced its work point system of peasant payment in collectivized agriculture with the "responsibility system," which permits increased worker initiative by allowing smaller production teams or individual households to maintain surpluses after meeting quotas established by contractual arrangement between the workers and the communes.<sup>28</sup> Since this policy shift, the "responsibility system," emphasizing individualistic choices, has dominated Chinese agriculture and is the primary source of rural industrial development. The state encouraged rural industry, operated by collectives and households, and small private enterprises in manufacturing and the service sector in urban areas. This encouragement resulted in a dramatic increase in both the number and the recognition of rural business enterprises owned by households and collectives, and of collectively owned urban enterprises.<sup>29</sup> By 1983, the World Bank estimated that the large urban collectives produced nearly 10 percent of China's net industrial output and accounted for one-fourth of

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the concept of separate judicial and administrative functions, it remained clear that the need for political commitment by judges existed and "because China has relatively few formally proclaimed laws and those that exist are vague, it was always clear that judicial and legal personnel were expected to decide on the basis of party policy, and more detailed day-to-day party directives and campaigns." *Id.* at 12.

27. The decisions reached at this meeting are summarized in K. LIEBERTHAL & B. DICKSON, *A RESEARCH GUIDE TO CENTRAL PARTY AND GOVERNMENT MEETINGS IN CHINA 1949-1986*, at 259-61 (1989).

These changes in policy were not officially recorded until the issuance, in 1980, of Communist Party Document No. 75, entitled "Certain Problems Concerning Further Strengthening and Improving the Responsibility Systems for Agricultural Production." This was first published in *Fortnightly Chats (Ban ye tan)* 8 Nov. 25, 1981, reprinted in 5 *ISSUES AND STUDIES* 74-83 (1981).

28. See White, *The Politics of Economic Reform in Chinese Industry: The Introduction of the Labour Contract System*, 1987 *CHINA Q.* 365.

29. In urban areas this was accelerated greatly by the Central Committee of the Communist Party of China, Decision on Reform of the Economic Structure, adopted by the Twelfth Central Committee of the Communist Party of China, Third Plenary Session, on October 20, 1984. This outlined a plan for economic modernization that stressed decentralization, reliance on market mechanisms, increasing privatization and independent economic decisions by individual enterprises. Significant parts of this document are translated in Chao & Yang, *Private Enterprise in China: The Developing Law of Collective Enterprises*, 19 *INT'L LAW.* 1215, 1217-18 nn.6-11 (1985).

industrial employment.<sup>30</sup> In 1984, the central government stated that collectively owned rural industries "must be treated as equals of state-owned enterprises and given the necessary aid in all respects by local governments."<sup>31</sup>

The state established joint ventures and special economic zones on a grander scale to attract foreign capital and technology.<sup>32</sup> Operating outside the centralized state plan, these joint ventures compete with the state owned and administered sectors of the economy. China liberalized ownership and control over land and encouraged long-term land leases, especially to foreign firms. The state permitted peasants to lease farmland from their less efficient counterparts. In addition, the state endeavored to increase the availability of urban housing, which had declined by 20 percent from 4.5 square meters per person in 1952 to 3.6 square meters per person in 1977.<sup>33</sup> As a result, from 1979 through 1983, the Chinese built an additional 395 million square meters, an average of 79 million square meters per year.<sup>34</sup> Still, this proved insufficient to meet the increasing demand for urban housing. More recent government efforts have focused on increasing rents to provide a fiscal surplus for building additional housing, and at the same time pressure individuals and work units to purchase apartments.<sup>35</sup> The government also has extended privatization into education: universities and primary schools may now impose tuition.<sup>36</sup>

In absolute terms, the growth of these economic associations is staggering. By the end of 1985, their total number exceeded 484,700, incorporating 4,201,400 members—yet this still comprised only 1.0 percent of China's rural labor force.<sup>37</sup> The average rate of growth of peasant incomes between 1978 and 1982, in real terms, was 17.8 percent between 1978 and 1982, as compared with a total increase of only 3.0 percent for

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30. 1 WORLD BANK, CHINA SOCIALIST ECONOMIC DEVELOPMENT 156 (1983).

31. This was contained in a report of a Circular issued by the State Council endorsing a Ministry of Agriculture study calling for expansion of rural industries. China Daily, Mar. 19, 1984, at 1, col. 1.

32. For an article written in outline form that provides a thorough introduction to the characteristics of China's SEZs and a description of individual zones, see Klitgaard & Rasmussen, *Preferential Treatment for Foreign Investment in the People's Republic of China: Special Economic Zones and Industrial Development Districts*, 7 HASTINGS INT'L & COMP. L. REV. 377 (1984).

33. Shulian, *Changing the Pattern of China's Economy*, in CHINA'S ECONOMIC REFORMS 55 (1982).

34. BEIJING REV., Aug. 27, 1984, statistical insert.

35. See *infra* notes 112-16 and accompanying text.

36. See *infra* notes 109-11 and accompanying text.

37. 1984 CHINA STATISTICAL Y.B. 92 (1986).

the twenty years prior to 1978.<sup>38</sup> By 1983, the government triumphantly claimed that only 2.7 percent of peasant families fell below the 1978 poverty line of 100 yuan.<sup>39</sup> Rural per capita net income reportedly grew at an average annual rate of 15 percent for the years 1980 through 1986.<sup>40</sup>

The growth in peasant markets also has been rapid. By 1983, the number of peasant markets exceeded 48,000 and accounted for 10.2 percent of retail sales.<sup>41</sup> Consequently, these free markets soon became competitors of the state markets, which continued to sell food and household goods at fixed prices. The overall result of this re-ordering of property rights and restoration of free markets has been rapid economic growth. From an average of 3.9 percent a year between 1958 and 1976, economic growth in China accelerated to 9 percent a year in the period from 1977 to 1985.<sup>42</sup> National income per capita rose by 6.6 percent a year between 1978 and 1984 compared with an increase of 3.9 percent in the 1953-1978 period.<sup>43</sup>

Another significant result of China's changing milieu of domestic property rights and its increased presence in international capital and trade markets has been that the training of lawyers, the re-establishment of its legal system, and the strengthening of its legal institutions have become a national priority.<sup>44</sup> Privatization also has brought with it

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38. China Daily, June 17, 1983, at 3, col. 1.

39. China Daily, Mar. 8, 1984, at 3, col. 1.

40. BEIJING REV., Mar. 16, 1987, at 25.

41. China Daily, Feb. 6, 1984, at 3, col. 1.

42. Perkins, *Reforming China's Economic System*, 26 J. ECON. LITERATURE 601, 627-28 (1988).

43. Balassa, *China's Economic Reforms in a Comparative Perspective*, in CHINESE ECONOMIC REFORM: HOW FAST? 134-35 (B. Reynolds ed. 1988).

44. The new emphasis on the stability of the legal system has brought a surge in the education of new lawyers and in the status of the profession. See, e.g., Kraus, *Legal Education in the People's Republic of China*, 13 SUFFOLK TRANSNAT'L L.J. 74 (1989); Depei & Kanter, *Legal Education in China*, 32 AM. J. COMP. L. 543 (1984); Herman, *The Education of China's Lawyers*, 46 ALB. L. REV. 789 (1982); Wang, *Teaching and Research of International Law in Present Day China*, 22 COLUM. J. TRANSNAT'L L. 77 (1983).

Recent years have seen an increase in the number of lawyers from 2800 in 1958 to 20,000 in 1985. China Daily, Dec. 5, 1985, at 4, col. 1. A more current report indicated that the number of lawyers had grown from 2500 full-time and 300 part-time lawyers in 1955, when they were banned in the 1957 anti-rightist campaign, to more than 40,000 at the end of 1986. Wang, *Reform Revives Role of Lawyers*, China Daily, Mar. 18, 1987, at 4, col. 1.

The first private law office in post-Liberation China opened in Shenzhen on May 4, 1988. China Daily, Business Weekly, May 8, 1988, at 1, col. 2. This revival goes on in

charges of exploitation of labor as individuals and specialized households hire employees. The state justifies this practice by "disallowing" exploitation, in light of China's developing country status, so as to permit a "certain degree" of hiring of laborers for the purposes of developing its private economy.<sup>45</sup> Regulations permit the hiring of six or seven apprentices or assistants. The employers are described officially as "small individual proprietors" who are "not capitalists."<sup>46</sup>

The Chinese justification for these reforms is based on two premises. The first is that a socialist commodity economy leads to faster growth and is not, as some contend, a road leading away from Chinese socialism. The Chinese claim that this contention is substantiated by the fact that the reforms work and is consistent with the Marxist principle that in a socialist economy, the state should reward each worker "according to his labor."<sup>47</sup>

As further proof of the argument that only a pragmatic and flexible economic approach can succeed, the Chinese maintain that the anti-materialistic ethos of the Cultural Revolution, which was couched in political fervor and rejection of Western culture, contact, and technology, led to economic stagnation that did not end until the period of economic reform began in 1978 under the slogan of the "four modernizations": the modernization of industry, agriculture, science, and technology.<sup>48</sup>

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the face of government admissions that Chinese tradition dies hard and that court officials are inundated with attempted bribes. In 1987 alone, high court officials reportedly turned down 54,600 bribes. *China Daily*, July 29, 1989, at 3, col. 1.

45. *People's Daily*, Apr. 10, 1983, col. 1.

46. *BEIJING REV.*, Apr. 30, 1984, at 19-20. Many would disagree, and have concluded that the contract employment system is too similar to the system of wage labor criticized by Marx. *See White, supra* note 28, at 378-81.

47. The Constitution of the People's Republic of China provides that "[t]he system of socialist public ownership supersedes the system of exploitation of man by man; it applies the principle of 'from each according to his ability, to each according to his work.'" *PRC CONST.* art. 6.

The overt conflicts between these policies and socialist theory are apparent. One report cited an official of the State Economic Commission who questioned where "economic levers" like taxation and supply and demand start operating. The report recognized the contradictions between giving increased power of self-determination to enterprises while simultaneously keeping to the "socialist road" and overall economic plans, and restructuring of the vast government bureaucracy so that it does not interfere with private managers' decisionmaking and instead requires government officials to supply only guidance. *Bonavia, Socialist Balancing Act*, *FAR E. ECON. REV.*, Oct. 10, 1985, at 36-38.

48. Actually, the growth rate of the Chinese economy had slowed down and it was "becoming mired in an economic crisis of severe bottlenecks, rapidly raising capital-output ratios, a stagnate standard of living, and serious increases in real resource costs per unit of output." *Dernberger, Reforms in China: Implications for U.S. Policy*, *AM.*

The second justification for the Chinese reform derives directly from the Marxist contention that capitalism is a necessary development along the road to socialism. Chinese society therefore skipped an essential stage of economic organization and the historical progression towards communism, namely, an advanced commodity economy. Having hurdled directly from a feudal system of peasant-based agriculture to a socialist society, the dialectic has been short-circuited, and capitalistic industrialization bypassed, and thus, China must return to this current stage and develop a successful, industrialized commodity economy, and have its manufacturing processes and consumer society intact before moving on to the next mandated stage in the Marxist continuum.<sup>49</sup>

China's vision of the future has large-scale state-owned enterprises existing together with privately owned firms, with an optimal mixture of economic planning and free markets being used to allocate resources.<sup>50</sup> The state would continue to run large, capital-intensive, nation-wide, and province-wide business organizations, such as banks, railroads, and the postal service.<sup>51</sup> Small businesses in the service and retail trades would be privatized completely, while existing state-owned units would be phased out by their sale to collectives or their lease to private managers. In addition, newly formed private businesses also would populate this sector of the economy.<sup>52</sup> Small, currently state-owned factories would be converted into cooperative enterprises with employees working

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ECON. REV., May 1989, at 21, 21.

49. Shades of these contentions can be heard in many articles published in English during this period. See Quian, *The Primary Stage of Socialism*, CHINA RECONSTRUCTS, Mar. 1988, at 15.

"Capitalism cannot be skipped, and we need to have make-up lessons on capitalism. We should rehabilitate capitalism and treat it as our model and mentor." Literature and Art Gazette, Aug. 23, 1986, *reprinted in* 21 CHINESE L. & GOV'T, Spring 1988, at 69. "We did leap over capitalism. How was the leap? It's rough. Is it socialism we leaped into? Not really. All things, or most things, are feudalist, except that they are painted over with a layer of Marxist and socialist color . . . . What is the result? History is now punishing us." Wag Ruowang, Speech at a Forum in Songjiang County, Shanghai, Oct. 28, 1986 *reprinted in id.* at 69-70. Many academics in the Soviet Union share this theory, and it now "advises its allies in the Third World to remain integrated in the capitalist world economy rather than jump directly to socialism." Evangelista, *New Thinking in Foreign Policy*, THE NATION, June 13, 1987, at 796.

50. Li, *Conceiving Ownership Reform in China*, (*Woguo suoyouzhǐ gaigede shexi-ang*), People's Daily, (Renmin Ribao) Sept. 26, 1986, *reprinted in* 22 CHINESE ECON. STUD., Winter 1988-89, at 72, 78.

51. *Id.* at 73.

52. *Id.* at 73-74. There is already a movement to create small collective businesses from previously state-owned shops by selling them to former employees. Chao & Yang, *supra* note 29, at 1220.

as co-op members, while no future state-owned factories would be built.<sup>53</sup> Existing and newly organized large and medium-sized manufacturing concerns would become joint-stock companies, with limited ownership liability, boards of directors, independent operations, and would maintain sole responsibility for gains and losses.<sup>54</sup> Joint foreign-Chinese enterprises would be run as stock companies with limited liability.<sup>55</sup> The ownership structure in rural areas would focus more on the system of household contracting of publicly owned farm land and cooperative ownership of enterprises run by villages and townships.<sup>56</sup> Commentators envision stock ownership as highly flexible and important to the national economy with the state maintaining working control of these enterprises by holding as little as one-third of their stock, while holding companies and private investors may own other firms.<sup>57</sup> This multi-ownership system likely is consistent with a socialist system in that workers, as a social group, will continue to own the means of production.<sup>58</sup>

Overall, privatization has led to a progression of Chinese law towards recognition of private rights and concomitant duties in property law matters. China has chosen to establish rights and duties by statutory law rather than orient these rights solely through systems of centralized economic and administrative regulatory control. The achievement of social control through traditional cultural patterns of respect for authority and vestigial Confucian doctrines in interpersonal property relationships appears to be a thing of the past.<sup>59</sup> Still, there may be reminders of the past both in the compromise of disputes, and in the melding of Confucian concepts of proper behavior and propriety into the process of applying the expanding statutory rules that acknowledge individuals as le-

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53. Li, *supra* note 50, at 73.

54. *Id.* at 73-74.

55. *Id.* at 74.

56. *Id.*

57. *Id.* at 75-76.

58. *Id.* at 73.

59. For instance, a contrast has been drawn between the lack of emphasis on "right" and "wrong" in traditional Confucian efforts at mediation and such emphasis in modern Chinese communist mediation proceedings. Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, 55 CALIF. L. REV. 1284 (1967). The same coercive power, which focuses on punishment and recordkeeping, and adjudicative emphasis on guilt or innocence has been found in the Comrades' Courts of the Soviet Union. See Lipson, *Law: The Function of Extra-Judicial Mechanisms*, in SOVIET AND CHINESE COMMUNISM: SIMILARITIES AND DIFFERENCES 144 (P. Threadgold ed. 1967); Berman & Spindler, *Soviet Comrades' Courts*, 38 WASH. L. REV. 842 (1963).

gal actors with the right to undertake economic activities and reap the corresponding benefits.<sup>60</sup>

### III. THE LEGAL BASIS FOR PRIVATIZATION

China's legal model for altering ownership rights and shifting from a centrally planned socialist economy to a market oriented economy derives from several sources. From a theoretical standpoint, the process of privatizing ownership rights can take many forms. State assets can be sold or ownership and control of state-owned assets or property rights can be transferred to private individuals. Free markets can be permitted a greater role in the allocation of resources. Actions can be taken to convey property rights to individuals or transfer functions that formerly belonged to the state. These actions include: hiring privately owned firms to perform services previously performed by the state ("contracting out"); providing individuals with vouchers for the purchase of goods and services from the private sector instead of providing those goods and services directly; shifting portions of the cost of goods, housing, and services previously provided or subsidized by the state to individuals; entirely eliminating or ignoring rules that regulate or restrict the scope of private activity; and granting individuals property rights that formerly were reserved to the state, such as the rights to own and transfer land and capital, hire workers, or engage in profitmaking activities. In addition, by lowering taxes or resisting pressures to impose high or confiscatory taxes, the state, in effect, is privatizing property. China has chosen to experiment with almost all of these methods and these changes are reflected in their legal system.

The Constitution of the People's Republic of China contains several specific clauses that delineate property ownership rights. Yet, the Constitution alone, without implementing laws or regulations, is not a source

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60. It has been noted that:

Because of the predominance of *li* over *fa*, the study of Chinese law must be all-embracing. To a much greater extent than is true of Western law, it must include the study of philosophy, religion, classics, history, politics, economics, sociology, and psychology. Preoccupation with scrutinizing, analyzing, and comparing statutes and court decisions—a skill that Western lawyers employ with dexterity and felicity—is futile and misleading because such an approach, devoid of insight into the makeup of Chinese society, would at best deal with symptoms and not causes.

Lee & Lai, *supra* note 5, at 1329 (footnote omitted).

"The concept of right and duty in Chinese tradition can only be seen by examining how, when, where and with what presupposed conditions they function in the whole of the social relationships." H. Kim, *supra* note 4, at 119.

of substantive rights.<sup>61</sup> Chinese courts will not grant standing to litigants seeking to enforce constitutional rights. Instead, analysts should consider the Constitution as a changing declaration of national policy that reinforces short-run policies, such as modernization, while simultaneously serving as a repository of the basic underlying theoretical tenets and overall goals of Chinese socialism. As such, the Constitution also serves as a source of operative laws and regulations to implement policy.<sup>62</sup> For these reasons, China has revised its Constitution four times since liberation and partially updated it again in 1988.<sup>63</sup> In 1988, a clause was added to endorse development of the individual economy as a supplement to the socialist public-owned sector. Article 11 provides:

The individual economy of urban and rural working people, operated 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, helps and supervises the individual economy by exercising administrative control.<sup>64</sup>

It is a centuries-old Chinese tradition that national policy takes precedence over written law.<sup>65</sup> This tradition manifests in other sections of the Constitution, such as article 126, which only appears to ensure judicial independence; instead, article 126 generally has been construed as requiring that courts follow national policy and act harmoniously with local government activities.<sup>66</sup>

To further the goal of privatization, China constitutionally ordains

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61. This aspect of Chinese jurisprudence was distinctively the understanding of law teachers and law students at Fudan University where one of the authors, James Kraus, taught. One commentator has reported that "a secret ruling of the Beijing Supreme People's Court in 1986, circulated for internal use only, laid down that the current Chinese State Constitution cannot be cited or appealed to in court proceedings." Tay & Kamenka, *supra* note 19, at 22 n.20.

62. The debate as to whether policy or law controls is formulated as well at the level of conflict between changing policy and statutory law. In arguing that the conflict must be resolved in favor of the legal regulations, one Chinese commentator concedes:

But for many years, both in theoretical research and in actual work, there have always been some who believe that policy is superior to law, that law is subordinate to policy, and even that law is something we can do without. Practice has proven that the view which scorns the law is mistaken and harmful.

Chen, *A Review of Thirty Years of Legal Studies in New China*, 2 J. CHINESE L. 181, 197 (1988).

63. See *supra* note 19 and accompanying text.

64. PRC CONST. art. 11.

65. Lee & Lai, *supra* note 5, at 1327.

66. *Id.*

property rights of foreigners exercising economic choices beneficial to Chinese economic development. Chinese law permits foreigners to invest in China and to enter into cooperative economic relationships with Chinese enterprises. China also guarantees that foreigners' "lawful rights and interests are protected" by Chinese law.<sup>67</sup> Chinese law further includes a commitment to refrain from nationalizing foreign investment and expropriating foreigners' property, unless necessary to serve the public interest. Even under this public interest exception, the government has agreed to follow designated legal procedures and to make reasonable compensation.<sup>68</sup> Moreover, China provides statutory protection for "productive materials" invested in China, and profits earned by foreigners who invest in China. Investors may transfer such profits and productive materials through inheritance, in addition to copyrights, patents, stocks, bonds, and other types of legal securities.<sup>69</sup> China also assures foreigners employed within its borders that they will be able to remit wages, salaries, and income earned abroad, after payment of Chinese income tax.<sup>70</sup>

This constitutional protection against the taking of property presuma-

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67. PRC CONST. art. 18.

Article 32 provides:

The People's Republic of China protects the lawful rights and interests of foreigners within Chinese territory, and while on Chinese territory foreigners must abide by the law of the People's Republic of China.

The People's Republic of China may grant asylum to foreigners who request it for political reasons.

PRC CONST. art. 32.

68. The Law of the People's Republic of China Concerning Enterprises Operated Exclusively with Foreign Capital, art. 5 (1986), provides: "Except under special circumstances . . . the state shall not nationalize or expropriate a wholly-owned foreign enterprise. Should it prove necessary to do so in the public interest, legal procedures will be followed and reasonable compensation will be made." Foreigners also are given rights as creditors and are subject to obligations as debtors. The General Principles of the Civil Law of the People's Republic of China, Chapter 5, § 2. *See generally* Jing, *Legal Guarantee for Foreign Investors*, BEIJING REV., June 2, 1986, at 4.

On the other hand, the United States policy towards expropriation of foreigners' property is constitutionally ordained. The Supreme Court has held that the fifth amendment applies to foreigners and that just compensation must be paid when their property is taken. *See* *Russian Volunteer Fleet v. United States*, 282 U.S. 481, 491-92 (1931); *Sardino v. Federal Reserve Bank of N.Y.*, 361 F.2d 106, 111 (2d Cir. 1966). The right applies even when the United States no longer recognizes the foreigner's government. *See, e.g., Russian Volunteer Fleet*, 282 U.S. at 492.

69. Law of Succession of the PRC, art. 36; PRC General Principles of the Civil Law, arts. 75, 76, 94, 95, 97.

70. The Law of the People's Republic of China on Enterprises Operated Exclusively with Foreign Capital, art. 19 (1986).

bly does not apply to real property in China, since, at least theoretically, all real property is state-owned or controlled.<sup>71</sup> While the state owns all land, work units, farmers and agencies hold long-term rights to possess and occupy structures they have built on state land and can rent land for periods as long as fifteen years.<sup>72</sup> Recent changes in Chinese statutory laws implement these constitutional guarantees such that the law protects those who lease land from arbitrary interference with their use rights by state agencies, cadres, and communes seeking to obtain this land for non-public purposes.<sup>73</sup> The Chinese government puts existing rights to lease land to profitable use<sup>74</sup> by making valuable, sometimes underutilized, land available on long-term leases, especially to foreign concerns and joint ventures.<sup>75</sup>

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71. The Constitution of the People's Republic of China provides that:

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 privately farmed 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 organizations or individual may appropriate, buy, sell or lease land, or unlawfully transfer land in other ways.

PRC CONST. art. 10.

72. Private ownership of residential real property is permitted in China, primarily in rural areas. The state is involved only to the extent of ensuring the sale prices of such property are fair, and that it receives reports of each sale. Carl, *supra* note 20, at 1269.

It has been stressed that peasants should be allowed to transfer agricultural land to more efficient farmers during this 15 year period. See People's Daily, Jan. 20, 1984, at 1. The leasing or sale of houses apparently has become a problem since the government has prohibited those who sell or lease their houses in villages and towns from obtaining allocations of land to build others. See Regulations On the Administration of the Land for Building Houses in Villages and Towns, art. 15 (1982), reprinted in COMMERCIAL LAWS AND BUSINESS REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA 145, 146 (F. Sit ed. 1983) [hereinafter COMMERCIAL LAWS].

73. See Regulations On the Requisition of Land For State Construction, arts. 9 and 25 (1982), reprinted in, COMMERCIAL LAWS, *supra* note 72, at 148-49, 152.

74. The Fourteenth Routine Meeting of the State Council of the People's Republic of China passed Interim Regulations on the Sale and Transfer of the Right of Use of State Owned Land in Cities and Towns. Guangming Ri Bao, July 23, 1988, at 1 (translation). The process of registering the users of state-owned land has begun in order to determine who is actually making use of land. People's Daily, Sept. 16, 1988, at 1 (overseas ed.).

75. The central government has decided to allow the leasing of land in the Special Economic Zones (SEZs) and in major cities. Until 1987, the state had been renting out land at very low cost or allocating it free for productive use. Such leasing is expected to contribute to the income of many local governments who, in the future, will have to balance their budgets with little help from Beijing. Cheng, *Special Economic Zones Face*

Chinese commentators generally applaud the development of contractual relations, which they see as facilitating the commoditization, specialization, and socialization of the rural economy.<sup>76</sup> The foundation of these personal property rights rests on the constitutional protection afforded to citizens to own and inherit private property.<sup>77</sup> These personal property rights include the right to own, transfer, and otherwise control, houses, savings accounts, personal effects, domestic animals, earned income, securities and bonds, and any other kind of property that individuals can own legally.<sup>78</sup> An owner of property, including residential housing and commercial property, maintains the right to occupy, use, devise, or sell property according to the procedures delineated by Chinese law and may retain any appreciation in value.<sup>79</sup> According to the Law of Succession, all lawful private property, including benefits from private contracts, is inheritable.<sup>80</sup>

Chinese concepts of private contractual rights are progressing steadily from the sphere of personal property ownership, and the free market sale of food and other household items, to aspects of employment. Employment is shifting from a life tenure relationship to that of a privately bargained-for contractual property right, supported by a statutory scheme providing minimal worker protection. At present, state-owned farms and state-owned urban enterprises still employ the vast majority of

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*Fight for Capital*, FAR E. ECON. REV., Mar. 24, 1988, at 82-83.

Xiamen, in Fujian province, has auctioned long term land leases with maximum terms of 40 years for industrial land and 70 years for residential property. Only foreign currency was accepted as payment. South China Morning Post, Bus. Post, June 27, 1988, at 1, col. 2.

According to a summary of an article published by a Chinese economist in the Shanghai *World Economic Herald*, Shanghai land rentals are intended for foreign investors. Lessors will be limited to local government bodies or State delegates. Leases will be alienable, but will contain reversionary clauses upon the payment of compensation for unexpired terms. Lessors will maintain all mineral and water rights and, since ownership will remain in the State and the agreements and leases will be continually subject to Chinese law, leasing to foreigners will avoid the taint associated with the imperialistic "concessions" of pre-liberation Shanghai. China Daily, Dec. 5, 1987, at 4, col. 1.

76. See, e.g., Gu, *The Economic Contract Law is a Powerful Tool in Ensuring Implementation of the State Plan*, J. LEGAL STUD., May 3, 1982, at 7, reprinted in 18 CHINESE ECON. STUD. Spring 1985, at 50.

77. The Constitution provides that "[t]he state protects the right of citizens to own lawfully-earned income, savings, houses and other lawful property. The state protects by law the right of citizens to inherit private property." PRC CONST. art. 13.

78. PRC General Principles of the Civil Law, arts. 71-83.

79. *Id.* arts. 72-76.

80. Law of Succession of the People's Republic of China, arts. 1-4 (1985), reprinted in *People's Daily*, Apr. 14, 1985, at 3, col. 1.

workers.<sup>81</sup> The trend, however, is evolving toward a contract system of employment that limits what once was lifelong and often intergenerational job security. Children of workers can no longer lawfully inherit permanent jobs at urban factories as they could under the job substitution system, which allowed children to replace their parents upon retirement.<sup>82</sup> This system was a motivating factor in early retirement and a valuable guarantee for one's children in a state in which millions of recently graduated high school students were unemployed and unsure of the nature and quality of work to which they eventually would be assigned. The job substitution system benefited firms through the early retirement of costly older workers, who received higher salaries and larger bonuses than their replacements. Enterprises also benefited in that they needed to expend only limited efforts and financial resources to recruit new workers. Furthermore, the enterprises have benefited from gaining some assurance that the employer-employee relationship that had been established over many years with the parent would be transferred to their children, who might have a similar work attitude as the parent, be more diligent because of family pressure, and be more congenial because of existing friendships with fellow workers, who also often were family acquaintances.<sup>83</sup>

The precarious nature of job security under the contract system is

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81. One commentator has put the figures at 7.46 million contract workers and 75.47 million permanent workers, or 7.8% and 78.7% respectively of the state enterprise work force, as of March 1988. Josephs, *Labor Reform in the Workers' State: The Chinese Experience*, 2 J. CHINESE L. 201, 255 n.313 (1988). In the three months between September 1986 and December 1986, the number of contract workers increased from 3.65 million to 5.17 million, or from 4% to 5.6% of the state enterprise work force. Although the number of permanent workers also increased during this period, from 74.88 to 74.93 million, their number declined from 82% to 80% of the work force. *Id.* at 255.

More recent figures report 10.43 million contract workers, an increase of 360,000 during 1989. This is out of a total 134.99 million workers in state and local government owned enterprises, 99.2 million in state-run units, and 34.74 million in township-run units. Of these, 10.43 million in state-owned units were contract workers, an increase to 10.5%, from 4% in 1986. *China Daily*, July 26, 1989, at 3, col. 4.

82. The substitution system was officially abolished in 1983. See Guowuyuan Guanyu Renzhen Zhengdun Zhaoshou Tuixiu Tuizhi Zhigong Zinu Gongzuo de Tonzahi (State Council Circular on Regularizing the Recruitment of Children of Retired Workers), 13 LAODONG GONZI WENJIAN XUANBIAN (SELECTED DOCUMENTS ON LABOR AND WAGES) 162 (1983), translated in 2 COMMERCIAL LAWS & BUSINESS REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA 304-05 (1984).

83. The system also could backfire as parents often chose as their successors the least competent of their children, those who were physically unfit or those who were least likely to succeed in obtaining employment through the normal channels of assignment. Josephs, *supra* note 81, at 215.

compounded by the difficulty of predicting how Chinese courts will interpret employment contracts between individual workers and enterprises. For instance, the Economic Contracts Law of the People's Republic of China is not applicable to contracts between individuals or between individuals and business entities.<sup>84</sup> Even so, article 54 provides that "economic contracts signed by individual businesses or rural commune members with legal persons shall be carried out with reference to" the Economic Contracts Law.<sup>85</sup> In addition, Chinese law sets forth the "principle of equality and mutual benefit" and "agreement through consultation and compensation of equal value" as general principles governing economic contracts.<sup>86</sup> At present, wronged individuals can seek redress under the Provisional Regulations on the Implementation of the Contract Employment System in State Enterprises.<sup>87</sup> While these regulations safeguard contract workers from arbitrary dismissal during the term of their contract, they neither provide protection upon termination of the contract nor supply standards that would require renewal of employment contracts.<sup>88</sup>

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84. The Economic Contracts Law applies to business arrangements, such as "purchasing and marketing, subcontracting for construction projects, undertaking processing, goods transport, power supply and use, storage, property lease, loan, property insurance, scientific and technological cooperation and other economic contracts." The Economic Contracts Law of the People's Republic of China, art. 8, *reprinted in COMMERCIAL LAWS*, *supra* note 72, at 300. Similar protection is afforded foreign business contracts. *See* Foreign Related Economic Contracts Law of the People's Republic of China (1985).

The General Principles of Civil Law also would not apply, since it is intended to regulate economic and property relationships between parties of equal status, such as individuals. It does not apply to vertical economic relationships such as employment contracts. H. ZHENG, *CHINA'S CIVIL AND COMMERCIAL LAW* 24-25 (1988).

The Foreign Economic Contracts Law of the People's Republic of China and the Law of the People's Republic of China Concerning Wholly Foreign-Owned Enterprises fill in the remaining gaps. *See* Fang & Tang, *The Wholly Foreign-Owned Enterprise Law: Defining the Legislative History and Interpreting the Statute*, 2 J. CHINESE L. 153, 168-69 (1988).

85. The Economic Contracts Law of the People's Republic of China, art. 54, *reprinted in COMMERCIAL LAWS*, *supra* note 72, at 300, 308.

86. *Id.* art. 5, at 300.

87. Provisional Regulations on the Implementation of the Contract Employment System in State Enterprises (promulgated July 12, 1986, RMRB, Sept. 10, 1986, at 2, *reprinted in* Josephs, *supra* note 81, at 264-70 (Appendix A) [hereinafter Contract Employment Regulations]).

88. Josephs, *supra* note 81, at 235-38; Article 9 of the Contract Employment Regulations provides that the term of the employment contract shall be determined by consultation between the enterprise and the worker. The contract automatically expires at the end of its term. Except in the case of rotation workers, the contract may be renewed if

Privatization also has freed intellectual property from state monopolization. The new patent, trademark protection, and copyright laws, have replaced the prior method of providing random rewards for scientific discoveries, inventions, innovative industrial techniques and applications, and artistic achievements.<sup>89</sup>

Despite China's expanding constitutional and statutory protection of private property ownership rights, the Chinese legal system still lacks international and domestic credibility. Foreigners, especially those who carry on business in China, as well as Chinese citizens, continue to believe that the Chinese legal system is replete with vague laws and regulations and is obstructed by layers of bureaucracy. While Westerners approach the Chinese legal system with favorable expectations, gleaned from the certainty, stability, and consistent application of rules of their own legal cultures, Chinese citizens view these newly created rights with skepticism formed from years of living with legal guarantees and promises incorporated in vague and ambiguous codes, regulations, Communist Party documents, and internal rules that were not circulated openly. Chinese citizens have grown accustomed to a legal system that was incomplete, subject to arbitrary policy swings, staffed by poorly trained cadres who usually were held unaccountable for erroneous legal judgments, and to legal decisions that relied more on socialist goals and policies than a clear and consistent body of law. Consequently, in any discussion concerning the practical application of the growing body of laws governing economic reform, analysts must question not only the existence of statutes and regulations providing property rights, but also the ambiguity inherent in the wording of the laws that create these rights, and about the behavior that they actually permit.<sup>90</sup>

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production or work requires and the parties so agree. Contract Employment Regulations, *supra* note 87, art. 9, at 300.

89. For a thorough summary of Chinese patent, trademark, and copyright law, including an excellent historical introduction to each, see Sidel, *Copyright, Trademark and Patent Law in the People's Republic of China*, 21 *TEX. INT'L L.J.* 259 (1986). See also Note, *Patent Law in the People's Republic of China: A Primer*, 8 *N.Y.L. SCH. J. INT'L & COMP. L.* 451 (1987); Note, *The Patent Law of the People's Republic of China in Perspective*, 33 *UCLA L. REV.* 331 (1985).

90. From a Western perspective, commentators often have noted that clauses in the Chinese Constitution are ambiguous or vague, that policy pronouncements of the government are also often vague, and that officials know the legal limits of behavior, but these limits are not disclosed to the population which is expected to conform to them. Koeltl, *Civil Rights and Liberties in China*, 46 *ALB. L. REV.* 740, 743 (1982). Of course preciseness partially is a matter of legal training and tradition.

In its form and structure, the [Nationality] law may be criticized for vagueness and incompleteness by Western lawyers who in their meticulous legal environment

## IV. THE IMPACT ON CHINESE SOCIETY

The rapid emergence of private ownership rights through changes in Chinese law and policy has had a dramatic and marked socioeconomic impact on Chinese society. For the average citizen, especially urban residents, these changing ownership rights require movement away from the security of guaranteed lifetime employment, from subsidized prices for essential family needs, such as medical care, housing, education, basic foods, clothing, and other household items, and from a focus on the internal environment of the work unit as the source of worldly goods and status. The concerns of Chinese citizens are shifting to a realm of expanded choices: a more uncertain life in which economic choice increasingly is being transferred from the state to the individual and the protective layers of the Chinese socialist cocoon are being shed involuntarily.

The Chinese people's responses to these changes are not uniform. The Chinese prefer the benefits brought by freer markets, yet simultaneously seek to preserve the security of the past. Privatization efforts in the industrial sector and agriculture have brought a decade of rapid economic growth. Changes in the manufacturing sector have yielded a greater va-

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may consider the law devoid of detailed rules and procedural regulations. Moreover, the broad scope of discretionary power given to China's public security agencies in the administration of the law may also cause uneasiness to some outsiders. These characteristics, however, are not uncommon to both China's traditional and current socialist legal system, where the purpose of administrative law is simply to provide guidelines for authorities to flexibly apply the law in a particular context.

Chen, *The Nationality Law of the People's Republic of China and the Overseas Chinese in Hong Kong, Macao and Southeast Asia*, 5 N.Y.L. SCH. J. INT'L & COMP. L. 281, 324-25 (1984). It also is the position of many Chinese legal scholars that, at least in the early stages of development, China's socialist legal system needs to mature slowly. "It is perfectly normal for an incomplete legal system to exist for a certain period in a newly established state." Wu, *Building New China's Legal System*, 22 COLUM. J. TRANSNAT'L L. 1, 17-18 (1983).

The new Joint Venture Income Tax Law confuses, rather than simplifies, joint venture planning. From the Western perspective, the most obvious flaw in the new law is its ambiguous phraseology. The Chinese favor short, broadly worded tax statutes: together, the 1950 Income Tax Law and the 1958 Consolidated Tax Law represent little more than a skeletal regulatory framework. Perhaps as with the Joint Venture Law, the Chinese anticipate that foreign participants will "fill in the gaps" via the negotiation process. Although this system of ad hoc contracting may typify the Chinese penchant for experimentation, uncertainties regarding tax liability may lessen investor confidence and slow China's modernization.

Note, *Taxation of Joint Ventures in the People's Republic of China: A Legal Analysis in the Context of Current Chinese Economic and Political Conditions*, 15 VAND. J. TRANSNAT'L L. 513, 546-47 (1982) (footnotes omitted).

riety of higher quality domestically manufactured consumer goods.<sup>91</sup> Similarly, expanding imports and foreign investment have meant access to foreign products, both those that China imports and those that foreign companies manufacture inside China.

### A. Rural and Urban Workforces

Both the top and bottom strata of Chinese society favor the changes in the labor market, especially the increased mobility, the end of restrictive lifetime job tenure, and the demise of the job assignment system. University students, feeling that they have the skills and bargaining power to conquer a free labor market, applaud the withering of the job assignment system.<sup>92</sup> The millions of individuals who recently have migrated from the poorest rural areas to large cities and form the core of urban workers performing manual and household labor also favor the reforms. The influx of these workers to urban areas has been dramatic: the number of self-employed laborers in cities and towns grew from 150,000 in 1978 to 4.52 million by the end of 1985.<sup>93</sup> Their movement from the

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91. Butterfield, *From Coke to Marlboro, U.S. Takes Hold in China*, N.Y. Times, July 19, 1989, at A8, col. 2.

92. The pace of change in China can be gleaned from May 1985 directives of the central government concerning reforms in the job assignment process and tuition payments. Some of these already are out of date. Three methods of job assignment were contemplated: 1) assigned jobs taking into account students' wishes and school recommendations cushioned by efforts to recruit students from hardship areas and specialized trades; 2) contracts between students and units which provide for unit-subsidized tuition payments in return for student employment commitments after graduation; and 3) enrollment of a small number of self-supporting students outside of state plans who will be permitted to find jobs for themselves. Free tuition appears to be a thing of the past, except for students who work in hardship positions after graduation and those with outstanding academic records or who are too poor to support themselves. REFORM OF CHINA'S EDUCATIONAL STRUCTURE 14-15 (1985) (Decision of the CPC Central Committee).

Reasons for the new job assignment policies were explained by Li Hai Ji, Deputy Minister of the State Education Commission, at a Fulbright Conference held in Xiamen, on February 6, 1988. In the past all students were given a job, but this resulted in objections from the students and a loss of motivation since the university represented a safe place. The new policy is to let the mechanism of supply and demand grow as part of the process of job placement and to provide the students with more freedom of choice. Eventually only special jobs will be assigned, such as those in teaching, those in mining, and those having jobs in remote locations and rough conditions. The authorities are looking for policies to motivate students to accept less desirable jobs through an incentive system. Address by Li Hai Ji at Fulbright Mid-Year Conference in Xiamen, The People's Republic of China (Feb. 6, 1988).

93. Statistics of the Industry and Commerce Bureau, reported in Zhu, *On the Evolu-*

countryside is a result of labor reform, rapid economic growth in the cities, and disproportionate application of government investment in urban coastal areas. An additional factor is the futile government attempts to regulate this influx by means of a household registration system and the denial of food ration coupons to unregistered urban residents.<sup>94</sup>

Still, most Chinese, especially the vast majority of urban workers who form the middle strata of Chinese society, seek job security and prefer positions in state factories, even at lower wages, over the risks inherent in private employment and the contract system.<sup>95</sup> Most choose to remain employed by state-run enterprises. Post-reform studies of high school seniors and university students show that they retain the goal of finding a position that provides the security of lifetime employment.<sup>96</sup> A study of Shanghai high school students indicated that the students considered the "self-employed worker" as the least desirable job category on a list of thirty-eight occupations.<sup>97</sup> Another study found that a majority of high school and university students in the Chaoyang District of Beijing pre-

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*tion and Changes of Individual Economy and Countermeasures (Qianlun Geti Jingjide Fazhan Bianhua Ji Duice)*, 66 REFERENCE MATERIAL FOR ECON. STUD. (JINGJI YANJIU CANKAO ZILIAO) 33 (1986), reprinted in 21 CHINESE ECON. STUD., Winter 1978-88, at 100, 101.

94. The system of urban residency permits and household registration was effective in deterring migration as long as employment in urban areas was confined largely to state managed firms. Grain rationing was effective as well, as long as jobs remained scarce and there were few free markets selling food at uncontrolled prices. Once private businesses and free urban markets were permitted, however, free market food, rented living spaces, and inexpensive restaurants became available. Additionally, a black market developed in the excess ration coupons of urban households. They often were exchanged for plastic household utensils and then sold to those illegally residing in urban areas. Although the registration system had been successful in limiting the overflow growth of Chinese cities, it worked a great hardship on unemployed peasants who were restricted even from obtaining seasonal employment in the cities. See W. HINTON, SHENFAN 106-09 (1983).

95. For instance, one poll indicated that 55% of those Chinese workers who responded would not leave their jobs for more satisfying employment, even though they had no interest in their current jobs. Gongren Ribao, Jan. 2, 1987, at 4.

96. Lan & Zhang, *Aspirations and Inclination of this Year's Senior High School Graduates (Yingjie gaozhong biyesheng de zhiyuan qingzhang)*, Shehui [Society] May 1982, at 22-25, reprinted in POLICY CONFLICTS IN POST-MAO CHINA 71, 79 (1986); Guo, *Survey and Analysis of the Sense of Employment Awareness Among Young People in Chaoyang District Schools (Chaoyang qu zaixiao qingnian juyue yishi diaocha yu fenxi)*, 6 COLLECTED ESSAYS ON YOUTH EMPLOYMENT AND LABOR (QINGNIAN JIUYE YU LAODONG LUNCONG) 52 (1985), reprinted in 21 CHINESE ECON. STUD., Summer 1988, at 6.

97. Lan & Zhang, *supra* note 96, at 76.

ferred state enterprises to private employment.<sup>98</sup>

The opening of job markets and increased mobility also has had other effects, including the exacerbation of employment sex discrimination and the general level of unemployment. When the job assignment system prevailed, universities, technical schools, and secondary schools, which were the primary sources of employees and were responsible for administering placements, had a large degree of control over the distribution of graduates and could act to minimize gender discrimination. The fourfold goals of the assignment system were 1) to assure adequate supplies of trained workers for units that were undesirable because of their geographical location and working conditions; 2) to absorb surplus labor and guarantee employment by allocating unneeded workers to work units, especially state-run units; 3) to reduce movement into urban areas by restricting the free flow of labor through permanent assignments; and 4) to modulate student behavior and political activity to some extent through the implied threat of unwanted job assignments.<sup>99</sup> Many organizations received their annual quotas of university graduates regardless of need, which resulted in wasted resources, underemployment, blocked paths to promotion, and overall discontent. This process not only kept unemployment relatively low, but also reduced the potential for sex discrimination. Through their involvement in the process of placing graduates, educational institutions had input into specific assignments and could cushion discrimination. Before the economic reform, employers had limited motivation to exercise favoritism since they often were allocated surplus workers, and the pre-economic reform problems of extra workers, worker inefficiency, absenteeism, and financial loss were of minimal importance.<sup>100</sup> As reform takes hold and mandatory allocations of unneeded

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98. Guo, *supra* note 96, at 24.

99. One of the authors, James Kraus, has heard law students, agricultural students, teacher trainees, and graduate students in numerous disciplines complain of this policy. The primary justification for the policy is the need to allocate scarce talented and trained personnel essential to less desirable and poorer areas. Without the policy, these areas could not compete in a free market with the financial incentives and living conditions available in wealthier areas. It is also used to prevent further crowding of urban areas. The inconvenience to students is justified as repayment of the cost of their free university education. Students view it as authoritarian, impersonalized, and inefficient. The benefit to the individual is assured employment. A talented university graduate is not likely to trade these burdens for the benefits of a guaranteed job and lifetime security, especially since they have never faced unemployment.

100. An article that appeared in the China Labour Press indicated that state-owned enterprises and agencies had more than 20 million "redundant," surplus workers, constituting 9% of the total workforce. China Daily, July 11, 1989, at 4, col. 4.

Other sources place the level of underemployment in China at 30-40% of the rural

new workers become a thing of the past, firms are feeling increasing pressure to earn profits and to justify new hiring. The firms are using their vast oversupplies of surplus employees, accumulated from previous years' excessive allocations, to fill vacant positions and reduce labor costs. Now that entry level positions are becoming scarce, competition for desirable positions, especially in urban locations, has become fierce. *Quanxi*, the web of connections and influence endemic to all aspects of Chinese life, is becoming increasingly present in obtaining employment, and firms freely exercise a natural inclination to favor male applicants.<sup>101</sup> These changes, however, have a denigrating effect on the advances women have made in the work force.<sup>102</sup>

The broad impact of the reforms on unemployment has yet to surface, largely due to the fact that the economy's growth rate has enabled employers to absorb many workers. In addition, the scope of the impact is somewhat uncertain because of inadequate methods of determining the number seeking work, the fact that most urban workers are still in permanent positions, and contracts agreed to by new job market entrants since the introduction of the contract system have yet to expire.<sup>103</sup> The

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labor force and 33% of industrial employment. Reynolds, *Trade, Employment, and Inequality in Postreform China*, in CHINESE ECONOMIC REFORM 189, 191 (B. Reynolds ed. 1988).

101. Schools are encouraging students to use *quanxi* since they are having difficulty placing students under the new voluntary system. China Daily, July 6, 1989, at 5, col. 1.

102. For example, 80% of the 1987 women graduates from the People's University's School of Journalism, the best in the country, could not find jobs. Hood, *Ideal of Social Equity Falls By the Wayside as Reforms Gather Pace*, Sunday Morning Post, Feb. 7, 1988, at 11, col. 1. Zhang Yuquan, vice-director of the Job-Assignment Department for College Graduates of the Beijing Personnel Bureau, noted that women graduates often have a more difficult time finding desirable jobs. China Daily, Apr. 28, 1988, at 1, col. 1. An investigation of more than 600 enterprises by the All-China Federation of Trade Unions concluded that 17,000 women workers lost their original jobs in the first half of 1987 and that enterprises were hiring fewer women. China Daily, Nov. 25, 1987, at 4, col. 1.

There is a general trend in China in favor of women returning to positions as homemakers and becoming less threatening to men in the job market. These attitudes appear to be fostered by national acceptance of a lower status for women. There are no women on the Political Bureau Standing Committee and the number in county and township governments is declining. Zheng, *Why Fewer Women at Leading Posts?* BEIJING REV., Mar. 13, 1988, at 7. This is occurring despite a constitutional guarantee of "equal rights with men in all spheres of life, political, economic, cultural and social, including family life." PRC CONST. art. 48.

103. Earlier reports concluded that the government objective of expanding private enterprise as a means to absorb unemployed workers had been successful. *Report of the Central Committee of the Chinese Communist Party and the State Council, Decision on*

government also has provided itself with sufficient leeway in that it has abandoned its insistence that unemployment was negligible and now, in effect, acknowledges that a 4 percent level of unemployment is expected and acceptable.<sup>104</sup> Inevitably, unemployment will swell as employment contracts expire and the employers' preference for younger workers willing to accept lower wages becomes widespread.

### B. *Financial Concerns*

For the average family in China, the new policies have resulted in feelings of heightened economic insecurity, greater uncertainty, and actual financial hardship. The new policies affect almost every aspect of daily life. Although wages have increased, inflation is far outstripping these gains.<sup>105</sup> In July 1989, the rate of inflation stood at 25.5 percent, exceeding the average salary increase of 18.8 percent for Chinese workers in the first half of 1989.<sup>106</sup> Food prices, close to half of the budget of

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*Solving Urban Employment Problems* (1981), excerpted in *BEIJING REV.*, Feb. 8, 1982, at 21.

If accurate methods of determining unemployment were introduced, it would almost certainly be acknowledged as higher. By the end of 1985 there were already a total of 17 million self-employed workers in urban areas. No doubt many were seeking jobs. Statistics of the Industry and Commerce Bureau, reported in *Zhu*, *supra* note 93, at 100-01. Although still relatively small as a percentage of all workers, the number of contract workers is increasing. See *supra* note 81 and accompanying text.

104. The government has concluded that an unemployment rate of less than 4% is necessary to prevent social instability. *China Daily*, July 11, 1989, at 4, col. 4.

105. The Chinese government acknowledges that despite average salary increases of 18.8% for Chinese workers in the first half of 1989, real incomes decreased as a result of the rise in the price of staples. *China Daily*, July 26, 1989, at 3, col. 4.

106. *China Daily*, July 26, 1989, at 3, col. 4; Summary of a Report in *Economic Daily*, *China Daily*, July 27, 1989, at 4, col. 1.

The pace and impact of inflation has been reported widely both inside China and internationally. In 1984, the monetary supply increased by 49.50%, while the economy grew at a rate of 18.47%. In 1986, the figures were 23.34% and 12.59%, respectively. Price increases were 6% in 1986 and 7.3% in 1987. Jia, *On the Problem of Today's Prices*, *Guangmin Ri Bao*, Aug. 12, 1988, at 3 (translation). Even in May 1987, the Chinese government was admitting to average increases of 20% in the price of commodities and declining living standards for 21% of residents in large cities. *China Daily*, May 2, 1988, at 4, col. 1. Zhao Ziyang, then General Secretary of the Chinese Communist Party, reportedly said that in order to speed reform, China must control inflation and restrain demand while it carries on reform of the price system. *People's Daily* (overseas ed.), Sept. 14, 1988, at 1, col. 7.

Wage increases in China have outstripped inflation for several years, but these figures tell only half the story. Consumers complain that the retail price index (the basis of its compilation is not known) does not accurately reflect their spending behavior. About half of household expenditure is on food, the item which has the most unstable prices and the

most Chinese urban households, have been especially hard hit. Advance announcements of the removal of price controls on specific items have caused hoarding and panic buying, with stores often withholding goods from sale with the intention of awaiting the opportunity to sell them at higher prices.<sup>107</sup> The impact especially has been difficult for the numerous workers in government institutions, whose wages previously were at an egalitarian and relatively low level and rose only 14.5 percent in the first half of 1989, as compared to the general salary increase of 18.8 percent for other Chinese workers.<sup>108</sup>

Significantly, Chinese citizens blame the economic reforms for spiraling inflation, even though heightened consumer demand partially is responsible. To mitigate the impact of inflation in the short run, the opportunity to take second jobs and open private businesses has become available. Moonlighting is an avenue taken increasingly by university teachers, while skilled workers rely on early retirement and pension-supplementing wages from full-time employment in private or collectively run businesses.<sup>109</sup> Earnings from these sources, however, have further

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highest increases. Prices of poultry, meat, fish, and vegetables in urban free markets rose by as much as 17% in 1987 compared to the previous year. Do Rosario, *Inflation: The Threat to Further Changes*, FAR E. ECON. REV., Mar. 24, 1988, at 61.

The actual impact on urban consumers is even more severe than these figures indicate. Accustomed to relatively stable prices, urban residents are now facing official inflation rates of 24% and widely acknowledged, but unofficial, rates closer to 50%. Gargan, *China's Economy Takes Small Leap Backward*, N.Y. Times, Sept. 26, 1988, at A10, col. 3. In spite of the enthusiasm of Chinese citizens for the changes in economic policy, the most significant political question is what will be their reaction when the impact of higher housing costs, the end of the cooking oil subsidy, and overall inflation sets in? Overholser, *Nuts and Bolts of Reform in China*, Int'l Herald Tribune, May 5, 1988, at 6, col. 3.

The most recent reports indicate that both the rate of inflation and economic growth have decreased sharply, but that any attempt to stimulate growth is likely to renew inflationary pressure. Dunn, *The Economics of Popular Discontent*, N.Y. Times, Apr. 16, 1990, at A1, col. 1.

107. For the average citizen, inflation means government-announced price increases of up to 60% on basic foods such as pork, eggs, sugar, and vegetables. China Daily, May 14, 1988, at 3, col. 1. It also means panic buying of cigarettes and liquor as drastic price increases are put into effect to match black market prices, South China Morning Post, July 27, 1988, at 1, col. 5, and it means illegally buying foreign currency (usually United States dollars) on the black market as a hedge against inflation. *Bootlegging the Renminbi*, Asia Week, Aug. 19, 1988, at 48.

108. China Daily, July 26, 1989, at 3, col. 4; *Summary of a Report in Economic Daily*, China Daily, July 27, 1989, at 4, col. 1.

109. Faculty increasingly are forced, by the failure of the central government to pace their salaries with inflation and the general policy encouraging individual initiative, to find part-time positions, some of which pay more than their full-time university posts.

fueled consumer demand.

Families of university bound students are fearful of paying tuition on top of the already soaring expenses of providing their children with higher education. Reports indicate that even before universities imposed tuition, 34 percent of undergraduates necessarily relied on financial support from their parents, part-time employment, or both, to supplement their education expenses beyond the government subsidies.<sup>110</sup> The universal right to an education at state expense, from nursery school through graduate school, no longer exists in China.<sup>111</sup>

New housing policies, which resulted from efforts to privatize residential housing, also have resulted in financial hardship. While in rural areas newly obtained wealth has led to a surge in private homebuilding, urban residents continue to pay subsidized rents that average less than 4

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Recent reports indicate that more than a million Chinese employed in specialized and technical fields, about 14% of the total, hold second full or part-time positions. China Daily, May 28, 1988, at 3, col. 1.

110. China Daily, June 7, 1988, at 3, col. 1. Until recently there has been debate as to whether these business efforts were too capitalistic. China Daily, May 28, 1988, at 1, col. 3. The practice of universities admitting students who could pay their own tuition began in 1985. Their number was indicated as small: 1030 students entering in 1986, 14,000 in 1987, 16,000 in 1988, paying an average of 1200 yuan per year. Wang, *Educational Competition*, Quang Min Ri Bao, June 10, 1988, at 1.

111. China's longstanding practice of free college tuition and living expenses appears to be a thing of the past. As of the 1987-88 academic year, China is replacing this practice with a new loan system. Students gradually will take on part of the expense of their education through participation in work-study programs, financial support from their work units, or through their own funds. The new plan is being applied to all areas of China except the five autonomous regions and four provinces of Yunnan, Guizhou, Qinghai and Gansu, which contain large number of minorities. It is an effort by the Chinese government to reduce its costly 2300 yuan (\$622) annual subsidization of each of China's 1.9 million college students. *Scholarly Development in China*, CHINA EXCHANGE NEWS, Sept.-Dec. 1987, at 21-22.

In the fall of 1989, 21 colleges and universities in Shanghai enrolled 1451 students who studied at their own expense. With annual payments varying from 1200 yuan (about \$324) to 1600 yuan (about \$432). China Daily, Aug. 5, 1989, at 3, col. 6. Families realize that the reduction in the number of students subsidized by the government is more than that needed to offset the increase in the number paying tuition. *Id.* The cut in overall enrollment is 30,000. China Daily, July 22, 1989, at 1, col. 1.

It is ironic that China has turned to the Carnegie Foundation for the Advancement of Teaching to study changes in the Chinese university system and assist it in imposing an education tax and tuition. Carmody, *China Seeks American Help for an Education Overhaul*, N.Y. Times, Nov. 13, 1988, at A1, col. 1.

A progressive education tax on wage earners is being proposed to improve school facilities, the quality of instructors, and teacher salaries. Ma, *Education Tax Suggested to Ease Shortage of Funds*, China Daily, July 7, 1989, at 5, col. 1.

percent of their gross income.<sup>112</sup> Urban rent subsidies by the government and work units is the largest single factor that makes comparison of the urban standard of living of Chinese families with those in other societies difficult.<sup>113</sup> Payment of any amount of rent approaching the market costs of constructing and maintaining housing drastically would curtail urban standards of living since wages are fixed at extraordinarily low levels. Still, the shortage of sufficient residential housing in urban areas and the inability of new construction to match the growing population is a crisis of severe proportions. As a means to finance the construction of needed housing, to curb inflation by absorbing excess disposable income otherwise available for the purchase of consumer goods, and to offset more closely the maintenance expenses of existing housing by current rental receipts, the Chinese have taken steps toward privatizing residential housing. This growing free marketization and privatization of housing has thus far failed to absorb personal savings and temper the pent-up demand for durable goods.<sup>114</sup> The government, however, is pressuring urban tenants to save and purchase rental units through the introduction of increased rents—sometimes as much as tenfold—and a system of off-

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112. Gao Shangquan, Vice-minister in charge of the State Commission for Restructuring the Economy recently was quoted as stating: "Statistics show that the average living space per person dwindled from 4.5 square meters in the early 1950's to 3.6 meters in 1978. [Yet] the average family spends only 1 to 2% of its monthly income on rents." *China Daily*, Mar. 19, 1988, at 4, col. 1. "[A]ccording to a recent sample survey among approximately 16,000 families, rent constitutes only about 2.6 per cent of the total family income . . ." *Around Shanghai*, *China Daily*, May 7, 1988, at 6, col. 2.

113. "Most urban dwellers pay only nominal, fixed low rents and controlled low prices for grain and non staple foodstuffs such as meat sold through the state distribution system." Delfs, *Run for Election, But Do Not Expect to Win*, *FAR E. ECON. REV.*, Mar. 24, 1988, at 56-58.

A clash between two work units gives some indication of the market value of housing in crowded Beijing. An engineer who sought a transfer from the Beijing Heavy Machinery Factory to the Northern Communications University in Beijing was asked to vacate his work unit supplied apartment or pay a 120,000 yuan (\$32,400) mortgage as a precondition to transfer. The university offered to pay two years of higher rent after which he would give up the apartment. The factory refused. *See China Daily*, Nov. 27, 1987, at 3, col. 4.

114. For instance, Gao Shangquan, Vice-minister in charge of the State Commission for Restructuring the Economy, blamed China's climbing inflation rate on the low cost of housing, since it fueled consumer demand for other things, mainly durables and food. He said that the ultimate goal of the current changes in housing policy was to commercialize the whole process of housing construction and distribution. *China Daily*, Mar. 19, 1988, at 4, col. 1. Other reports have confirmed that the long-term objective of the housing reform is to realize the privatization of residential housing. *People's Daily*, Aug. 25, 1988, at 1, col. 1 (overseas ed.).

setting credits, which are based on such factors as per capita occupancy and age and condition of the rental unit.<sup>115</sup> If the amount of the credit exceeds the rent paid before the increase went into effect, the tenant is given monthly vouchers covering the difference and may use them toward the purchase of owner-occupied housing. The reformers hope that the policies of raising urban rents and promoting the purchase of existing and newly built housing will be favored by the ordinary people in part because the market system is thought to decrease corruption.<sup>116</sup>

The income gap between rich and poor rural households also is growing because of the introduction of the "household responsibility system" and the ability for individuals to accumulate the capital and expertise necessary to develop successful sideline businesses.<sup>117</sup> Reports circulate

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115. Lin Hanxiong, the Director of the Ministry of Construction, stressed that the proper climate must be created for private purchase and ownership through the building of more new units to be sold and by the sale of publicly owned units to their current residents. *People's Daily*, Oct. 4, 1988, at 1, col. 1 (overseas ed.). A report in *China Daily* noted that "[d]etailed plans to reform the country's housing system over the next three to five years have been revealed. They include the raising of rents, the promotion of selling houses to individuals, and the laying of a foundation for the commercialization of house construction and allocation." *China Daily*, Mar. 29, 1988, at 3, col. 2.

So far sales are not very brisk. It is one thing to get urban dwellers in the United States, accustomed to paying 35% of their income for rent, to purchase apartment units and quite another to get Chinese citizens, accustomed to paying less than 4% of their income for rent, to spend their life savings on previously rented living space. In Xian, Shaanxi Province, high prices left nearly 90% of the apartments unsold. Of more than 10,000 apartments offered for sale by 29 companies, only 1100 were sold. Most were sold to buyers purchasing with public funds. Only 484 were sold to private individuals, almost all of whom were business contractors, private enterprisers, old cadres no longer in office, and people who purchased with the financial support of overseas relatives. Only three or four apartments were purchased by private individuals using funds from their own savings. *China Daily*, June 16, 1988, at 3, col. 4. *But see* *People's Daily*, Sept. 6, 1988, at 3, col. 4 (overseas ed.) (report indicates 77,000 urban families purchased units in 1987).

116. The scheme is being promoted on the basis that the market system will decrease corruption. Officials have conceded that as long as housing charges remain irrationally low that no administrative means will be effective to eliminate fraud in housing distribution by people in senior positions. *China Daily*, Mar. 19, 1988, at 4, col. 1. Fortunately, it appears that those in power are ready to suffer along with the masses. *Around Shanghai*, *China Daily*, May 7, 1988, at 6, col. 2. (Jiang Zemin, then secretary of the Shanghai Municipal Party Committee, currently Communist Party Secretary, Chairman of the Central Military Commission and Deng Xiaoping's alleged successor, promised in a meeting that when the housing reform policy comes into effect, he will also pay more for larger housing space).

117. Hinton, *A Trip to Fengyang County: Investigating China's New Family Contract System*, 35 *MONTHLY REV.* 6, 24-26 (1983).

that corrupt practices permeated the distribution of assets of rural collectives when the state distributed collectively-held agricultural land and farm equipment to member families and provided credit to begin specialized family enterprises.<sup>118</sup>

### C. *Public Perception and Social Concerns*

Regardless of the actual rise in urban workers' real incomes and living standards, many Chinese believe that those willing to accept the risks of the free market policies are amassing fortunes, often through corruption, connections, unscrupulous practices, nonsocialist activities, tax evasion, and cheating on industrial safety.<sup>119</sup> The average citizen's monthly income does not even approach the 800 yuan monthly level requiring the payment of income tax, yet the perceptions are that those in private businesses with large cash flows routinely avoid income tax payments and that fortunes are being made through outright corrupt practices.<sup>120</sup>

The government, in turn, only reinforces these perceptions via the recurring publicity it injects in campaigns to strengthen the tax collection

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118. As one might expect, William Hinton has strong feelings on the subject. "It is doubtful if, in the history of the world, any privileged group ever acquired more for less. The scale of these transactions and the depth of the injury done to the average coop member boggles the mind." Hinton, *A Response to Hugh Deane*, 40 MONTHLY REV. 10, 21 (1989).

119. The first years of the reforms, 1978-1983, resulted in rural workers improving their income in comparison to urban workers along with a national reduction in income inequality. To be sure, they also resulted in greater rural income inequality as some peasants were able to increase greatly their share of income. Adelman & Sunding, *Economic Policy and Income Distribution in China*, in CHINESE ECONOMIC REFORM: HOW FAR, HOW FAST? 154, 162, 169 (B. Reynolds ed. 1988). China's income inequality remains one of the lowest of any nation. *Id.* at 170.

120. See Delfs, *Run for Election, But Do Not Expect to Win*, FAR E. ECON. REV., Mar. 24, 1988, at 56-58 (quoting a February 1988 report in Economic Daily):

Private business owners' average income nationwide was estimated at Rmb 3,036 in 1985, according to a survey of 12 provinces and cities . . . A more recent survey of private businesses in Peking indicated an average net income of Rmb 4,908 in 1987. Private transport operators had the highest income of all, averaging Rmb 9,348. Actual incomes might be even twice as high, the newspaper suggested, due to under-reporting for purposes of tax evasion.

Those in show business also have been criticized for not paying taxes. China Daily, Nov. 27, 1987, at 3, col. 1. Personal income taxes are payable on monthly earnings in excess of Rmb 400. *Id.*

The two tier pricing system allowed many to become rich by using connections to purchase raw materials and commodities at low, fixed state plan prices and to resell them at free market prices, earning a huge profit. Chan, *China's Long Winter*, 41 MONTHLY REV. 1, 8-10 (1990).

system and combat corruption.<sup>121</sup> Many Chinese also believe that the reform policies are innately nonegalitarian and that the government's pronouncements that a few must get rich first so others can follow simply magnifies the level of corruption endemic to Chinese society.<sup>122</sup> The government's subsequent announcements of campaigns to reduce corruption among government officials and to press for tax reform retroactively have conceded the validity of, and thereby legitimized, the claims of corruption. It is this corruption that formed the basis for one of the central demands of the student-led demonstrations that swept China in May and June of 1989.<sup>123</sup>

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121. Corruption has long been a popular theme in Chinese society. Illegal tax surcharges imposed by the gentry on farmers reached as high as 250% in the nineteenth century, with the government receiving very little from these collections. Wakeman, *The Evolution of Local Control in Late Imperial China*, in *CONFLICT AND CONTROL IN LATE IMPERIAL CHINA* 15 (F. Wakeman ed. 1975). Foreigners were not exempt from such tactics. During the nineteenth century, the government designated Chinese merchants to act as intermediaries for the conduct of foreign trade in Canton. These merchants exacted large arbitrary payoffs as the price of doing business. Cohen, *supra* note 8, at 333.

Anti-corruption campaigns are hardly novel in post-liberation China. The judiciary in particular suffered greatly during the Three-Anti Campaign of 1952 which focused on alleged wide-spread bribery, miscarriages of justice, and corruption. See Tay & Kamenka, *supra* note 19, at 9-10.

At times, the extent of alleged corruption can reach the comical. For instance, the latest anti-corruption campaign was reported to have been so successful in Jiangxi province that a ban on the use of public funds to hold banquets resulted in a 70% loss of business for restaurants. China Daily, July 7, 1989, at 1, col. 7.

122. There have been reports of jealous neighbors trampling crops and injuring the son of a highly successful farmer. Perry, *Rural Violence in Socialist China*, 103 *CHINA Q.* 414, 438 (1985).

123. Corruption is the only demand of the democracy movement that the government has acknowledged as valid by its subsequent campaigns. Leaders such as Jiang Zemin, named by Deng Xiaoping as his successor, continue to label the demonstrations as a counter-revolutionary rebellion, while expressing agreement with student discontent over corruption. N.Y. Times, Sept. 27, 1989, at A6, col. 3. Typical of past June 1989 articles, besides attempts to brand demonstrators as counter-revolutionaries, conspirators, and troublemakers, are those which vilify bourgeois democracy as detrimental to the final aim of developing "socialist democracy." China Daily, July 24, 1989, at 4, col. 1 (summarizing a People's Daily article of July 21, 1989); China Daily, July 20, 1989, at 4, col. 1; China Daily, July 28, 1989, at 4, col. 1 (citing a People's Daily article from July 26, 1989 on rebellion).

Recent campaigns to rid the country of corruption are widespread. China Daily, July 7, 1989, at 1, col. 7 (nationwide anti-corruption campaign); China Daily, July 10, 1989, at 1, col. 1 (severely penalize senior officials in Heilongjiang Province and punish tax dodgers); China Daily, July 31, 1989, at 3, col. 1 (root out "illegitimate" and illegal businesses); China Daily, July 27, 1989, at 1, col. 1 (creation of a special investigation to

Throughout China, individual initiative is subjugating the communal spirit identified with Chinese socialism. For instance, peasants are neglecting water conservation and irrigation projects and instead are tending to individual plots. One report indicates that post-reform investment in water conservation in some provinces is down 70 percent to 80 percent, resulting in a significant contraction of irrigated area.<sup>124</sup> While China's destruction of its forests, misuse of arable land, and water pollution have been documented for centuries, many Chinese blame the post-reform industrialization for current environmental problems. Ironically, this placement of blame also is the partial result of a magnified government recognition, following the Cultural Revolution, of the need to improve the environment.<sup>125</sup> Small towns that developed into urban centers have seen their air and water quality decline rapidly as China transforms, in a single generation, from a rural society to one in which industry intrudes on the countryside. The countervailing policy of encouraging industrial growth in rural areas to absorb surplus workers and thereby stem the movement to urban areas has resulted in a proliferation of small, widely dispersed factories. With an abundant supply of cheap labor, these enterprises are too numerous to police and therefore lack the inclination, expertise, and funds to concern themselves with environmental protection.<sup>126</sup>

Reform also has brought a decline in the level of social welfare benefits. Until recently, urban industrial and government workers and peas-

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probe corruption in the tobacco industry); *China Daily*, July 14, 1989, at 3, col. 2 (provide regulations to curb "rampant" corruption in Shanghai's enterprises); *China Daily*, July 12, 1989, at 4, col. 1 (Report of a People's Daily editorial arguing that punishment of corruption is a crucial step toward reviving the Communist Party's prestige).

While the democracy movement, which is characterized by brutal termination and subsequent arrests, imprisonment, and executions of participants, remains the focus of most discussions of China, the authors feel that it is too early to measure the long-term impact of government reactions to the democracy movement. The long-range trends in property rights this article examines are policies that the government consistently has promised to continue and therefore remain ripe for current analysis.

124. Walker, *Chinese Agriculture During the Period of Readjustment, 1978-83*, 100 *CHINA Q.* 783, 800 (1984); Wiens, *Poverty and Progress in the Huang and Huai River Basins*, in *CHINESE RURAL DEVELOPMENT: THE GREAT TRANSFORMATION* 90 (W. Parish ed. 1985).

125. For a concise summary of this environmental awakening, see Ross & Silk, *Environmental Regulation: Developments and Trends*, *E. ASIAN EXECUTIVE REP.*, Nov. 15, 1988, at 9.

126. China's 8000 small paper mills have been recognized as the worst polluters. They are part of the paper processing industry, which is responsible for discharging nearly 20% of China's waste water and accounting for 25% of the organic pollution in China's waters. *China Daily*, July 12, 1989, at 5, col. 3.

ants linked to rural communes and state farms viewed free medical services, drugs, retirement pensions, and emergency financial assistance as matters of right.<sup>127</sup> The rural communes had served as the agents for providing medical services, retirement benefits, and emergency financial assistance. Not surprisingly, the decline of these communes has brought with it a sharp decline in medical coverage and funding of retirement benefits. Many peasants must now pay for their own medical care, provide for retirement, and rely on family members for emergency aid. It also is not surprising that school attendance has plummeted in rural areas as farmers seek short-run profits and adults, drained from fields into rural factories, are replaced by child laborers.<sup>128</sup> Furthermore, the depletion of collective welfare funds and consequent collapse of welfare services has been reported. For instance, the number of brigades with cooperative medical care systems declined from 80 percent in the 1970s to 58 percent in 1981.<sup>129</sup>

Urban workers, particularly those employed privately or by small collectives, also have no social insurance protection.<sup>130</sup> When large work units are jettisoned, medical coverage, retirement pensions, housing, nursery school care for young children, prescription medicines, workers' compensation protection, and low priced consumer goods all are sacrificed, making the workers' independence costly. In a society that until recently was unwilling even to acknowledge the existence of unemployment, the state just now is considering a state-financed system of unemployment insurance to cushion job changes.<sup>131</sup>

For the average Chinese citizen, the expansion of property rights and freedom of choice has brought with it insecurity, uncertainty, unfamiliar

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127. See *supra* notes 20-21 and accompanying text.

128. In 1988, about 4.28 million primary school pupils quit school, 3.3% of total enrollment, and 2.87 million high school students left, about 6.9% of the total. Ma, *Education Tax Suggested to Ease Shortage of Funds*, *China Daily*, July 5, 1989, at 5, col. 1.

129. Parish, *Introduction: Historical Background and Current Issues*, in *CHINESE RURAL DEVELOPMENT: THE GREAT TRANSFORMATION* 21 (W. Parish ed. 1985).

130. The Labor Insurance Regulations of 1953 apply only to firms with at least 100 employees. They must provide pensions, funded partially through worker payments. *China Daily*, Aug. 5, 1989, at 1, col. 1.

131. A recent article outlines the creation of a worker employee retirement insurance system, to be established "within a few years," which will provide workers in state-owned enterprises, collective enterprises, private businesses, and foreign-funded businesses with retirement pensions, funded partially through worker payments. *China Daily*, Aug. 5, 1989, at 1, col. 1. It will replace the one now in effect, which since 1953 has required that enterprises with workforces of at least 100 provide retirement, medical, unemployment, and industrial injury benefits. *Id.* Workers will now be required to contribute to the funding of retirement benefits. *Id.*

financial burdens, inflation, a relative abundance of consumer goods, and broad questions about the future of Chinese socialism, socialist ideals, and the usefulness of supporting collective action in Chinese society. While a few individuals have become relatively wealthy, most have been left with envy and a sense that corruption is spreading and that only those who act illegally can succeed.<sup>132</sup>

## V. COMPARISONS TO CHILE AND THE SOVIET UNION

The privatization taking place in China stems in part from the widely held belief that socialist policies and state-owned enterprises are obstacles to rapid economic growth.<sup>133</sup> As the leaders of socialist states increas-

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132. Perceptions concerning the illegal practices of private enterprises are well supported by evidence. One court-sponsored task force discovered that 29.6% of private businesses were engaged in illegal activities. They included: entering into fraudulent purchase agreements, failing to report earnings and pay income taxes, using fake trademarks and forged labels, and selling adulterated food. Lu, *Contract Disputes by Individually Owned Small Businesses*, 1 MANUSCRIPTS & MATERIALS (WENGAO YU ZILIAO) 27 (1987), reprinted in 21 CHINESE ECON. STUD. Winter 1987-88, at 115, 116-18.

It would seem that participating in illegal activities may be necessary for a business to survive. In one county, more than 28% of the licensed private businesses had suspended operation or closed down. *New Problems in the Growth of Individual Economy (Geti jingji fazhan zhong de xin wenti)*, 31 INDUSTRY AND BUSINESS ADMINISTRATION (GONGSHANG XINGZHENG GUANLI) 11 (1986), reprinted in 21 CHINESE ECON. STUD., Winter 1987-88, at 59.

133. From a historical perspective, "privatization" is a new phenomenon. The term originated in 1973 in Chile when the military junta began returning previously nationalized property to private hands. The word did not appear in Webster's dictionary until 1983, and in the Readers Guide to Periodical Literature until 1984. Although privatization is a new phenomenon, it is taking place on a world scale. A partial list of countries privatizing enterprises includes: Argentina, Belize, Brazil, Chile, Costa Rica, Honduras, Jamaica, and Mexico in Latin America; Angola, Benin, Burkina Faso, Burundi, Congo, Ghana, Guinea, Kenya, Malawi, Mauritania, Mozambique, Niger, Rwanda, Sao Tome, Somalia, South Africa, and Togo in Africa; Bangladesh, India, Japan, Malaysia, Pakistan, Philippines, Singapore, South Korea, Sri Lanka, Thailand, and Vietnam in Asia; Austria, England, Finland, France, Italy, Portugal, Spain, and Turkey in Europe; and Canada and the United States in North America. Of course, privatization is on the agenda in the socialist countries of eastern Europe.

In these states, there is near universal agreement that state owned enterprises (SOEs) have failed to achieve the objectives set out for them. The World Bank defines SOEs as "financially autonomous and legally distinct entities wholly or partly owned by central or subnational governments. Unlike government departments that generally depend on taxes, SOEs can earn most of their revenue by selling goods and services." WORLD BANK, WORLD DEVELOPMENT REPORT 1988, at 168.

The SOEs generally have not been very successful in making money. For instance, "[f]or the seven largest Latin American economies, the combined deficit of SOEs rose

ingly are preoccupied with quickening the pace of economic growth, the traditional socialist concern for an equitable distribution of income has faded into the background. Chile, for instance, quickly passed from a largely market-oriented economy into a period of rapid nationalization, socialist ownership, and centralized economic management, and just as quickly returned to an economic system dominated by market forces and private ownership. The Soviet Union, on the other hand, has retained a genuine concern for equity, resulting in a more hesitant privatization effort. These two countries represent poles of a privatization spectrum, while China exemplifies a middle path. In assessing China's likelihood of long term success in the reorganization of its property rights and the degree to which Chinese socialism is decaying, it is useful to consider other socialist states that have undergone or currently are undergoing similar economic reforms.

### A. Chile

Chile's autocratic government carried privatization to extremes with the justification of quickening economic growth. Chile's experiences, therefore, are a possible preview of China's future in that China, as an authoritative regime, parallels Chile's goals of fast growth and rapid privatization of large sectors of its economy.

Before 1973, Chile, like China, was a state in which the state's role in the economy was increasing.<sup>134</sup> This "socialization" process accelerated under the Unidad Popular (UP) government of Salvador Allende which was in power between 1970 and 1973.<sup>135</sup> The Allende government seized

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from about one percent of GNP in the mid-1970s to about four percent in 1980-82." WORLD BANK, WORLD DEVELOPMENT REPORT 1987, at 67. And in Africa, where governments controlled over 3000 enterprises in 1980, output per capita was larger than it had been in 1960. Callaghy & Wilson, *Africa: Policy, Reality or Ritual?*, in THE PROMISE OF PRIVATIZATION 179, 184 (R. Vernon ed. 1988).

134. "From the early 1920s until 1973, the government of Chile consistently increased its involvement in the satisfaction of basic human needs. With only a few short-term breaks in the trend, each government became more involved than the last in the economy, redistribution of resources, social services, and political participation in the decision-making process. Chile's economy became increasingly public-sector oriented." Solimano & Haignere, *Free-Market Policies and Nutrition in Chile: A Grim Future After a Short-Lived Success*, Center for Population and Family Health, Faculty of Medicine Columbia University, Working Paper No. 7, at 2 (May 1984).

135. The UP was a coalition of parties including the Communist Party and the Socialist Party. The leader of the UP, Salvador Allende Gossens, was elected president of Chile in 1970. Allende was a socialist who promised to lead his country down a peaceful road to socialism. The "peaceful road" ended when Allende was overthrown in a bloody *coup d' état* in 1973.

control of the multinational companies that mined copper in Chile,<sup>136</sup> along with hundreds of industrial enterprises,<sup>137</sup> and expropriated mil-

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136. On July 11, 1971, the Chilean Congress unanimously passed a bill nationalizing the Chilean holdings of the United States based multinational copper companies: Anaconda, Kennecott, and Cerro Corporation. With this act the Chilean state, in the interest of national development, regained control over "the fundamental wealth of the nation." Corporacion del Cobre, *Los Caminos del Cobre en Chile*, at 25, Chile celebrated July 11 as its second independence day, or, in Allende's words, "The Day of National Dignity." *El Cobre De Chile es Ahora Chileno: Discurso del Presidente Allende en el Dia de La Dignidad Nacional, Rancague 1 de July de 1971*, Empresa Editoria Nacional Quimantu, Santiago Chile, 1971.

The government decided to carry out the nationalization of copper not by an ordinary law, but by a constitutional amendment. Embodying the nationalization in Chile's most fundamental law would present it in the most impressive way, would emphasize that it flowed from Chile's very sovereignty as a nation, and would make it legally as unassailable as possible.

E. BOORSTEIN, ALLENDE'S CHILE 131 (1977). The nationalization of copper brought essentially all of Chile's natural resources under state control. The Empresa Nacional del Petroleo (ENAP) or National Petroleum Enterprise already was 100% state-owned when Allende took office. In December 1970, the State Development Corporation (CORFO), which owned 55% of the Pacific Steel Company, bought out the remaining shares. Pacific Steel "accounted for Chile's entire steel production of six hundred thousand tons, and one third of its iron-ore output." *Id.* at 138. Bethlehem-Chile Iron Mines, a subsidiary of Bethlehem Steel, was nationalized the following March and two other iron mining companies (Santa Barbara and Santa Fe) were taken over in November. By the end of 1971, 96% of the iron mining operations in Chile were in state hands. As for coal, Carbonifera Lota Schwager, which accounted for 85% of Chile's output, was nationalized in January. Finally, in May 1971, the state purchased the Sociedad Quimica y Minera which controlled nearly 80% of nitrate production in Chile and had been owned by the Guggenheims. The nationalization of copper, nitrates and iron ore gave the government control of over 90% of exports. *Id.* at 144.

137. In its first year, the UP also took control of more than 100 additional firms. Most of these, however, did not become the property of the state. Rather, legal ownership remained in private hands while state officials managed them. Furthermore, the manner in which they were taken over was haphazard, and seemed to follow more the logic of class struggle than a systematic plan. Often workers acted on their own to seize plants on the assumption that their actions would be supported by the government. The government of Chile in 1970 had a variety of ways by which it could acquire or control enterprises. It could acquire existing firms as it acquired the copper mines by passing a constitutional amendment to nationalize them or by expropriating them by decree because they were not operating in a manner consistent with national well-being or development. Lanera Austral, for example, was expropriated because it used imported synthetic fibers instead of the wool of sheep raised in Chile. Finally, the government could intervene in or requisition firms without acquiring them. This power stemmed from laws which empowered the state to take over the direction of a firm that produced necessities if the firm engaged in illegal activities or operated at less than capacity. Interventions and requisitions were by far the most frequently employed methods of the Allende govern-

lions of hectares of farmland,<sup>138</sup> controlled the prices of necessities,<sup>139</sup> raised worker wages,<sup>140</sup> and established or expanded a number of gov-

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ment. There were 128 interventions and 39 requisitions in 1971 compared to only four expropriations. P. Cantor, *Nationalization and Workers' Welfare: Chile and the Popular Unity in Retrospect* (available at University of Michigan library, 146 University Microfilms (1985)).

138. In its first year in power, the UP shifted the agrarian reform process begun under the previous administration of Eduardo Frei into high gear. This process entailed expropriating large estates and turning over the expropriated land to peasant co-operatives called "asentamientos." From July 28, 1967, when the law allowing such expropriations was passed, until November 1970, the Frei administration expropriated 1408 farms. From November 1970 until 1971, the Allende government expropriated 1587 farms. Under Frei, 826 asentamientos were formed. By comparison, in Allende's first year, 917 asentamientos were established. *Id.* Table 177.6.

139. The UP used price controls to keep inflation in check. Owners of private firms could be fined or imprisoned for charging more than official prices. "To put it bluntly," boasted a Chilean economist, "entrepreneurs had to think twice before attempting to evade the prices set because this wasn't just another government." Garcia, *Algunos Aspectos de la Política de Corto Plazao de 1971*, in *LA ECONOMIA CHILENA EN 1971* at 125 (1971). The effect of the price controls in the UP's first year was to decrease the rate of inflation as measured by Chile's consumer and wholesale price indices. The average annual rate of inflation for 1971, according to the consumer price index, was 22.1% compared to 34.9% in 1970. 2 *WORLD BANK, CHILE: AN ECONOMY IN TRANSITION* 544, table 9.3c (1983). The average rate of inflation for 1971 and 1970, according to the wholesale price index, was 18% and 36%, respectively. *Id.* at 545, Table 9.4.

Nevertheless, as the money supply more than doubled, real inflation was much higher and a black market developed for many goods. Furthermore, inflation as measured by the Consumer Price Index rapidly accelerated in later years from 20% in 1971 to 732% in 1972 to 2400% in 1973. P. Cantor, *supra* note 137, at table 177.5.

140. Increasing wages and salaries, and decreasing unemployment through government spending on public works and programs designed to benefit the poor were interrelated aspects of the UP's program to redistribute income. "The first important economic action taken by the UP government was with regard to the annual wage adjustment due in January." 1 *WORLD BANK, CHILE: AN ECONOMY IN TRANSITION* 63 (1983). On November 27, 1970, the UP's minister of finance, Americo Zorilla, explained the UP policy to increase all wages and salaries by at least 100% of the cost of living and the lowest wages and salaries by more than this. Banco Central, *Boletín Mensual*, Number 514, December 1970, at 1486. Ten days later, President Allende signed an agreement between the UP and the Central Unica de Trabajadores (CUT), the largest union in Chile, which committed his government to the wage and salary adjustments announced by Zorilla. Finally, passage of law number 17,416, early in 1971 raised the minimum wage 67% (14% in real terms since inflation in 1970 was 35%), increased all wages and salaries by at least as much as the rise in the cost of living, raised the incomes of the lowest paid group of workmen by 40%, and raised the incomes of the next highest paid group of workers by 38%. N. Garcia, *Algunos Aspectos de la Política de Corto Plazo de 1971*, in *LA ECONOMIA CHILENA 1971*, at 114 (1971). (Only the minimum wage provisions of this law were mandatory for the private sector). In addition, the law doubled

ernment programs designed to benefit the poorest Chileans.<sup>141</sup> As a result, the state-generated share of gross domestic product rose from 19.4 percent to 50.4 percent, the state's share of industrial output increased from 11 percent to 32 percent, the share of industrial capital belonging to the private sector decreased from 71.6 percent to 30.6 percent, the state eliminated private farms greater than eighty hectares in size, unemployment fell from 8.3 percent of the labor force to 3.1 percent, and thousands of poor Chileans found themselves eating meat regularly and being cared for by doctors for the first time.<sup>142</sup>

In 1973, in a bloody *coup d'état*, a military *junta* headed by Augusto Pinochet seized power.<sup>143</sup> The Pinochet regime relegated economic policy to the free-market ideologists whose neo-conservative, free-market philosophy coincided well with its promise to abandon Marxism. These economists, most of whom were trained at the University of Chicago, "took a basically socialist country and turned it, as much as anyone could, into a wide-open free-market society."<sup>144</sup> By the early 1980s, the

family allowances for blue collar workers, increased them 44% for white collar workers, by 150% for public officials and by 113% for the polices and armed forces. *Id.* at 114-15. "The result of these measures was a sharp increase in the real incomes of workers generally and particularly of the lowest paid members of the labor force. 1 WORLD BANK, CHILE: AN ECONOMY IN TRANSITION 63 (1983). The share of wages and salaries in the national income increased from 54% in 1970 to 59% in 1971. REPUBLICA DE CHILE ODEPLAN (OFICINA DE PLANIFICACION), INFORME ECONOMICO ANUAL 26 (1971). Family consumption increased by 13% in the same period, real wages of blue collar workers by 38% and real salaries of white collar workers by 12%. N. Garcia, *Algunos Aspectos de la Política de Corto Plazo de 1971*, in LA ECONOMIA CHILENA EN 1971, at 32 (1971).

141. In December 1970, for example, a free milk distribution program was begun. That same month, doctors, dentists, and pharmacists aboard a health train made a 35 day tour of Chile's southern provinces and dispensed free medical care to peasants. These and other programs decreased the rate of infant mortality by 21% in 1971 with respect to 1970. REPUBLICA DE CHILE ODEPLAN (OFICINA DE PLANIFICACION), INFORME ECONOMICO ANUAL 198 (1971).

142. With respect to the entire UP period from 1971-1973, "[l]ow-income workers, the retired, and the indigent were given a larger and improved share of health, housing, education and welfare services; scarce food and other supplies were made preferentially available to low-income neighborhoods; so-called illegal takeovers of land, houses, apartments and industrial plants were tolerated, if not encouraged . . ." M. MAMALAKIS, THE GROWTH AND STRUCTURE OF THE CHILEAN ECONOMY: FROM INDEPENDENCE TO ALLENDE 217 (1976).

143. On December 14, 1988, Chile had its first elections since the *coup d' état*. Patricio Aylwin, an opposition candidate, won. Hence, Pinochet gave up the Presidential sash on March 11, 1990. How much real power he transferred remains to be seen. Aylwin, however, has promised no major changes in economic policy.

144. Martin, *Crossroads*, Wall St. J., Dec. 29, 1987, at 14, col. 3.

Chilean government had guided over 400 enterprises through privatization,<sup>145</sup> it had sold more than three million hectares of previously state-owned land to individual farmers, and returned 2.8 million hectares to their former owners.<sup>146</sup> Furthermore, between 1973 and 1980, the Chilean *junta* reduced the number of state-controlled enterprises from 507 to 15.<sup>147</sup>

Since the *junta* seized power, the poorest Chileans have suffered while the richest have prospered. The *junta* eradicated collectivized agriculture, prices of most goods have soared beyond the means of the majority of Chileans,<sup>148</sup> the number of indigent Chileans has increased in absolute and relative terms,<sup>149</sup> wealth has become concentrated in fewer hands,<sup>150</sup> unemployment climbed and has remained high,<sup>151</sup> average real salaries have decreased, and the availability of medical care and other basic necessities to the poor has diminished.<sup>152</sup>

145. Privatization in Chile continued to the end of Pinochet's presidency. Over 1.2 billion dollars worth of assets were sold between 1985 and 1990. Privatizations in 1989 included the sale of the government-owned telecommunication company, ENTEL; the national airline, LAN Chile; and the electric utility companies in three cities. *CORFO Celebrates 50th Anniversary*, CHILE ECON. REP. May-June 1989, at 6.

146. 1 WORLD BANK, CHILE: AN ECONOMY IN TRANSITION 182 (1979).

147. A. FOXLEY, LATIN AMERICAN EXPERIMENTS IN NEOCONSERVATIVE ECONOMICS 61 (1983).

148. Within a month after the *junta* freed prices from government controls, prices doubled, tripled and then quadrupled. In 1978, the poorest households consumed 40% less meat, 40% less rice, 30% less milk, and 25% less sugar than in 1973. Cortezar, *Distribution del Ingreso, Empleo y Remuneraciones Reales en Chile: 1970-1978*, in 3 COLECCIONES ESTUDIOS CIEPLAN, Santiago, Chile, at 8.

149. A 1985 National Planning Office study showed that 25% of Chilean households were indigent and a little more than 45% in extreme poverty. Luque, *Las Trampas de la "red social,"* July 1988, at 18.

150. According to a study by Fernando Dahse, "[T]he period of history that began in September, 1973 has produced strong concentration in ownership and management of private enterprises, in almost every sector of national economic activity." Dahse provides a detailed breakdown of 20 economic groups, actually extended families, who, together with foreign owned multinationals, account for nearly all private economic activity in Chile. One group, the Cruzat-Larrain family, for example, controls at least one billion dollars worth of property in Chile. F. DAHSE, MAPA DE LA EXTREMA RIQUEZA 13 (1979).

151. The unemployment rate between 1975 and 1985 never dropped below 10.8% of the labor force. J. SHEAHAN, PATTERNS OF DEVELOPMENT IN LATIN AMERICA: POVERTY, REPRESSION, AND ECONOMIC STRATEGY 225 (1987). It "reached a low of 12% in 1981, and then shot up to 28% in 1983. For the whole decade, 1973-1983, the average share of the labor force without regular employment must have been about two and a half-times as high as in the the 1960s. *Id.* at 229-30.

152. "Since the 1973 coup, the Chilean health care system has been transformed

Despite this movement to freer markets and privatization, Chile's record of economic growth has been unexceptional. The average annual growth rate of Chile's gross national product (GNP) during the period of the UP was over 25 percent higher than that attained under the *junta*.<sup>153</sup> Until 1987, under the *junta*, production per capita was lower than in 1973.<sup>154</sup> The period of 1974-1986 experienced a growth rate of 2.1 percent or 0.6 percent per capita.<sup>155</sup> This compares to a 4.4 percent growth rate or 2.3 percent per capita growth from 1970 to 1973.<sup>156</sup> Although the GNP grew at rates of 5 percent or higher in nine of the fifteen years the *junta* was in power, the GNP dropped by 12.9 percent and 14.4 percent in 1975 and 1982, respectively.<sup>157</sup> Therefore, much of the alleged growth in the years following these recessions only was recuperative. While growth rates were high in a number of years, the negative effect was such that 1987 per capita income had not surpassed the level of income it had reached twenty years earlier.<sup>158</sup>

Privatization in Chile ultimately may be seen as an attempt by military leaders allied to a reactionary oligarchy to undo gains made by workers over many years and to restore their state to the rule of a plutocracy. Nevertheless, these actions are being justified as an attempt to provide the capitalist framework needed for faster economic growth. Minus the label "capitalist," this is the same basic rationale used by China's leaders to justify privatization in China. The essential idea—that the individual's drive to accumulate, when given free sway, as exists in a private enterprise system, leads one to undertake actions that

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from a mixture of private and public clinics and hospitals to an almost entirely privatized system in which adequate care can be had only for a price far beyond the means of the average Chilean." Hales, CHILE NET, Nov. 1988, at 3. A study by the Center for Population and Family Health of Columbia University concluded that scarlet fever, dysentery, whooping cough, measles, colds, flu, hepatitis and typhoid fever all showed clear increases since 1973. See Solimano & Haignere, *supra* note 134, at 7.

153. Cademartori, Chile: Economic Aspects of Democratization, report presented to the Convention of the Latin American Studies Association (March 1988).

154. *Id.*

155. WORLD BANK, WORLD DEVELOPMENT REPORT: 1983, at 98 (1983).

156. *Id.*

157. *Id.*

158. Cademartori, *supra* note 153, at 2.

A better set of policies would include vastly greater concern for the level of unemployment and the income of those at the lower end of the income distribution. Such concern could be made effective by more expansionary monetary and fiscal policy in periods of recession, steadier use of promotional exchange rates, and direct social investment.

J. SHEAHAN, *supra* note 151, at 235.

benefit everyone and ultimately result in faster growth—comes straight from Adam Smith.<sup>159</sup> But the privatization and other free-market policies introduced in Chile, which have led to a highly skewed distribution of income and two severe recessions, have not led to significantly faster growth. This is the most important lesson to be learned by the Chinese from privatization in Chile.

### B. *The Soviet Union*

Privatization in Chile took place after a *junta*, whose fundamental philosophy was antithetical to socialism, overthrew the existing socialist government. For the Pinochet government, private property was a fundamental right.<sup>160</sup> In the Soviet Union and China, on the other hand, privatization is the product of avowedly socialist governments which long had maintained that property rights ultimately must rest in the hands of the state and that central planners must allocate resources.

Recently, faced with slower economic growth rates and a concomitant loss of power and prestige, both China and the Soviet Union have begun to express doubts about state ownership of the means of production and central planning.<sup>161</sup> Economic growth in these centrally planned coun-

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159. One Chilean economist had noted that “[t]he economic program of the present government assigns a subsidiary role to the State . . . .” CHILEAN ECONOMIC POLICY 13 (J. Mendez ed. 1979). He then concluded that:

The greater the State interference in a society, the less is its true liberty . . . . The right to private property requires legal guarantees against arbitrary dispossession. To this end it must be established that the state may only expropriate in cases of real necessity for the common good, and must pay just and timely compensation to the affected party.

*Id.* at 30, 32.

160. “The state should only keep for itself that property which is strategic or vital to the country, and cannot be left, prudently, in limited private hands; all else should be left open to the right of private ownership.” CHILEAN ECONOMIC POLICY, *supra* note 159, at 31. The extent of private property rights are often the cornerstone of distinctions between capitalistic and socialistic systems. A fair idea of what is meant by “private property” rights in a capitalistic economy may be derived from William Blackstone’s statement that “[t]here 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 the external things of the world, in total exclusion of the right of any other individual in the universe.” R. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 22 (1985) (quoting W. BLACKSTONE, COMMENTARIES 2 (1765)). For a capitalistic system to function, private property rights must be defined and enforced. *See* M. FRIEDMAN, CAPITALISM AND FREEDOM 27 (1962).

161. There are no statistics measuring economic growth rates that are wholly reliable for comparison purposes between countries. The difficulties of computing growth

tries had been slower in recent years, declining sharply from past growth rates calculated at 6.6 percent for China, under its first five year plan, and 4.5 percent for the Soviet Union from 1929 to 1979.<sup>162</sup> Since the Soviet Union became the first state to develop a central planning apparatus in 1928, which China subsequently adopted in 1954, this decline especially was disconcerting for both states.<sup>163</sup> As a result of the contrac-

rates even for a single market economy are legion. When it comes to deriving comparable statistics for non-market economies, especially over long periods of time, the problems multiply. Even so, studies indicate that "[t]he Soviet Union entered the 1980s with its worst economic performance of the post-war period." E. HEWETT, *REFORMING THE SOVIET ECONOMY* 256 (1988).

The Central Intelligence Agency and the Defense Intelligence Agency reported that the average annual growth rate of gross national product in the Soviet Union fell from 5% in the 1960-1970 period to 3.2% from 1971 to 1975, 2.2% from 1976 to 1980, and 1.9% from 1981 to 1985. The Central Intelligence Agency and The Defense Intelligence Agency, *The Soviet Economy in 1988*, paper presented to the National Security Council Subcommittee of the Joint Economic Committee of the United States Congress, at 41, table 84 (1989). They estimate that in 1988 the Soviet economy grew by only 1.5%. *Id.*

162. Perkins, *supra* note 42, at 627. During the period the Soviet economy grew at an average annual growth rate of 4.3%, the economy of the United States could manage a growth rate of only 3.1%. P. GREGORY & R. STUART, *SOVIET ECONOMIC STRUCTURE AND PERFORMANCE* 324 (1981).

163. It has been argued that the Soviets resorted to central planning as a spontaneous response to circumstances. Planning was not introduced by the Bolsheviks when they seized power in Russia in 1917. Rather, central planning was a mechanism which evolved as a means of allocating resources after the state had collectivized agricultural land and nationalized virtually all private enterprise in the country. Though the elimination of private enterprise had been a fundamental socialist goal handed down from Marx and Engels when the Russian revolution took place in 1917, no blueprint existed for how an economy should be run after all resources were in state hands. They "set up by stages the centralized system of production planning and supply allocation that we now consider the essential feature of Soviet-type economies. The market, and spontaneous forces generally, came to be regarded as phenomena hostile to socialist construction, to the carrying out of plans to transform a backward country at breakneck speed." A. NOVE, *THE SOVIET ECONOMIC SYSTEM* 20 (1982). Some see the Bolshevik process of nationalization itself, such as the seizure of 37,000 enterprises after World War I, as a response to circumstances. In the Russia of 1918-1920, a country reduced to economic collapse by tsarism and military defeat, state control was seen as a categorical necessity. H. SHUKMAN, *LENIN AND THE RUSSIAN REVOLUTION* 133 (1967).

It also has been contended that central planning sprung logically from the wellspring of socialist thought. Engels has written:

[W]ith the extension of the production of commodities, and especially with the introduction of the capitalist mode of production . . . producers were more and more turned into independent, isolated producers of commodities. It became apparent that the production of society at large was ruled by absence of plan, by accident, by anarchy; and this anarchy grew to greater and greater height. . . . [and] [w]ith the seizing of the means of production by society, production of com-

tion in growth, economists in both China and the Soviet Union agree that state-owned enterprises were failing to achieve their stated production and economic objectives and that centralized planning was resulting in resource misallocation.<sup>164</sup>

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modities is done away with, and simultaneously, the mastery of the product over the producer. Anarchy in social production is replaced by systematic definite organization. The struggle for individual existence disappears.

F. ENGELS, *SOCIALISM: UTOPIAN AND SCIENTIFIC* 60, 72 (1935).

The Soviet planning system as we have known it, until recently, was largely an invention of Joseph Stalin. He set up a central planning apparatus and gave as its primary responsibility the rapid transformation of a largely agricultural country into an advanced industrial power. For Stalin, socialist ideals took a back seat to economic growth. See P. GREGORY & R. STUART, *supra* note 162, at 335.

164. While some economists attribute the rapid growth of the Soviet economy to borrowed advanced technology and a readily available labor supply, most would credit the introduction of central planning and management with having accelerated the pace of growth. See P. GREGORY & R. STUART, *supra* note 162, at 397-98. Furthermore, scholars of all political persuasions rightly emphasize two related points. The first is that it is highly unlikely that under a democratic government the Soviet Union could have succeeded in industrializing as rapidly as it did:

The Soviet Union . . . extracted a large "surplus" from the peasantry (even though this meant starvation for some). These resources were used to build industry, but very little went for consumer goods; almost all of the initial resources were used to build factories to build more factories. Not only the peasants, but most of the urban workers were held to a low standard of living, with no increase in sight for many years. Such a program can be put into operation only against popular resistance and with repressive measures. Thus the perceived need for rapid development and the strategy used to obtain it, as well as the preconditions of the Revolution and the violence with which it survived, led to a repressive dictatorship and to its continuation throughout the 1930s, 1940s, and 1950s.

Sherman, *The Second Soviet Revolution or the Transition from Statism to Socialism*, 41 *MONTHLY REV.*, March 1990, at 14, 16-17.

The second point is that the growth rates achieved in the Soviet Union were truly spectacular, given the obstacles it had to overcome. "The Soviet Union was a backward, predominantly agricultural, poverty ridden nation when the Bolsheviks took power in 1917." R. DANIELS, *RUSSIA* 86 (1964). There followed three years of civil war, after which the country was prostrate. "Wide stretches of the land lay desolate; communications were disrupted everywhere. Industrial production had fallen to only 16 per cent of its 1912 level. . . . tens of thousands of disbanded soldiers were roving the countryside in search of food." H. HUGHES, *CONTEMPORARY EUROPE: A HISTORY* 96 (5th ed. 1981). Somehow, under unimaginably difficult circumstances, a backward country in which 60% of the population was illiterate, 80% lived in the countryside, land productivity was one fourth of what it was in Britain, and what industry that existed was largely foreign owned, became a world power and the first nation to put a satellite into orbit. Or as Mikhail S. Gorbachev, with good reason, could boast:

Let us recall that the legacy of czarism left us an agrarian, economically backward country. In 1913, our share of world industrial production was just above 4%. The

As both growth rates and labor productivity fell, the shortcomings of the central planning system become more glaring.<sup>165</sup> The Soviet Union encountered the three inextricable problems that face central planners when they seek to organize an economy to maximize social welfare. The first problem is the difficulty of specifying a social welfare function. The mathematical description of how social welfare varies when any of a number of measurable quantities have been identified as affecting social welfare change is difficult, if not impossible, to determine accurately. Furthermore, once planners specify a social welfare function, the second problem they face is to allocate the state's resources in a way so as to produce the best combination of goods and services. The planners must collect and process a tremendous volume of information to determine availability and employment of resources and technologies.<sup>166</sup> No central planning body is capable of accurately gathering and processing this data to allocate resources optimally. The third problem is that even if the first two problems disappear and the central planners make their directives accurate and clear, there is a strong possibility that those responsible for implementing the directives will misinterpret or disobey them as they filter through the immense bureaucratic chain.<sup>167</sup> An additional difficulty is motivating managers, who are concerned primarily with meeting out-

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production of essential types of manufactured goods in Russia was dozens of times smaller than that of the U.S. There was no engineering industry to speak of . . . [g]rain and timber each accounted for one third of all exports. . . . [Yet] the Soviet Union today is second only to the U.S., and is first in Europe. The same can be said of its engineering industry. The Soviet Union leads the world in the production of oil, including gas condensate, natural gas, iron ore, ferrous metals, cement, mineral fertilizers, lumber, prefabricated reinforced concrete, and other items.

Wall St. J., Aug. 24, 1987, at 9 (advertisements).

165. One economist has noted that, "[i]n the final years of Brezhnev's leadership, the Soviet Union was by all accounts going downhill. The decay was visible on all fronts. While economists cited the declining growth rate of the economy . . . others concentrated on recurring shortages, increasing corruption, and massive alienation." P. DESAI, *PERESTROIKA IN PERSPECTIVE* 3 (1989).

166. The Soviet economist O.K. Antonov stated that Kiev mathematicians have calculated that drafting an accurate and fully integrated plan of material-technical supply for the Ukrainian republic for one year would require the labor of the entire world's population for ten million years. A. NOVE, *supra* note 163, at 53 (quoting O. ANTONOV, *DLYA VSEKH I DLYA SEBYA: O SOVETSHENSTVOVANII POKAZATELEY PLANIROVANIYA SOTSIALISTICHES KOGO PROMYSHLENNOGO PROIZVODSTVA* 23 (1965)).

167. Communicating accurately is often a two way street. Managers, rewarded according to how well they fulfill output production targets, have an incentive to understate their capabilities so that they will be assigned targets easily within reach. This also is an incentive to overstate their input requirements for raw materials and labor.

put targets, to search simultaneously for new technologies and cost saving devices. Therefore, both the Soviet Union and China have relied heavily on research academies and institutes for most of their research and development.<sup>168</sup> These research tanks are remote from the life and problems of factories, and are an additional reason that both have fallen behind other states in the race to develop new technologies.

For all of these reasons, the Soviet Union has introduced Mikhail Gorbachev's *perestroika* or "restructuring" reforms aimed at spurring economic growth. Through decentralization, the managers of manufacturing enterprises realize greater autonomy just as the markets will realize a greater role in allocating resources. The result of managerial autonomy is a reduction in the authority of central planners. The Soviet privatization reforms consist of granting the managers of state-owned enterprises more decision making powers, the legalization of cooperatives and other forms of private ownership, new provisions for investment, and agricultural restructuring.

The *khozraschet* and *samofnansirovanie* (self-financing) are economic accountability reforms that have given the managers of state-owned enterprises more powers. The state intends these laws, which it imposed at the end of 1987, to link more closely the welfare of workers and managers of state-owned enterprises to the performance of those enterprises, while simultaneously granting them greater responsibility for making decisions that will affect that performance.<sup>169</sup>

Self-financing refers to the fact that the Soviets will require managers of firms to use earned profits for investment purposes as well as expenses and that they will reduce bank loans and state subsidies. Furthermore, in theory, economic accountability implies that managers will have greater leeway to shop for inputs on their own and to negotiate the prices of those inputs. In addition, managers will be freer to determine their product mix.<sup>170</sup>

Economic accountability should also mean, in principle, that workers and managers will see their income fall if the profits of their enterprise decrease. Yet, the state continues to set prices for most goods and to require that firms meet state output directives. The new laws, therefore, contradict those that severely limit the flexibility of managers of individual enterprises. They give the workers and managers of enterprises most

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168. Berliner, *The Prospects for Technological Progress*, in *THE SOVIET ECONOMY: CONTINUITY AND CHANGE* 293, 300-02 (M. Bornstein ed. 1981); P. GREGORY & R. STUART, *supra* note 162, at 208.

169. E. HEWETT, *supra* note 161, at 331-32.

170. *Id.*

favored by the state, mandated prices and directives providing an unfair advantage over their counterparts. As a result, resentment of these aspects of reform has been widespread.

The introduction of many different forms of private enterprise in the Soviet Union represents what many view as the most dramatic and revolutionary change in Soviet policy. Prior to these changes, the state allowed only peasants to engage in any significant private entrepreneurial activities.<sup>171</sup> In 1987, the Soviets began allowing those individuals to whom it had granted special permission to go into business for themselves.<sup>172</sup> The state permitted individuals to employ students, disabled people, and pensioners, but prohibited the individuals from selling their output to state enterprises and limited the number of workers they could hire as well as their access to bank loans.<sup>173</sup> Despite the restrictions, thousands of cooperatives, concentrated in the service sector, such as restaurants, construction companies, research enterprises, and computer consulting firms sprung up. Finally, in May 1988, the Soviets eliminated the previous restrictions. By April 1, 1989, there were 99,300 co-ops in

171. A. NOVE, *supra* note 163, at 31-32. By 1985, these small private plots took up a total of only 1.4% of the cultivated land, "but they accounted for almost 60 percent of the fruit produced in the country, 28 percent of the meat and 23 percent of the milk." Hewett, *Reforming, the Soviet Economy*, THE NATION, June 13, 1987, at 803.

Of course, even before these changes, the Soviet economy showed *sub silentio* recognition of the imperfection of complete state control and there were markets over which the state exercised only partial or no control. "There [were] not just legal markets and black illegal markets, but an entire spectrum of "multicolored markets." Katsenelinboigen & Levine, *Market and Plan, Plan and Market: The Soviet Case*, in THE SOVIET ECONOMY: CONTINUITY AND CHANGE 61, 63 (M. Bornstein ed. 1981).

"[T]he market is the only mechanism capable of successfully distributing thousands of kinds of state-produced consumer goods and services among millions of Soviet households with widely divergent money incomes and tastes." They also channel scarce goods at prices above official rates in a society with deficiencies in production and distribution, allocate privately produced consumer goods and services, and provide a means for enterprises to barter materials. See Bornstein, *Introduction to Part I*, in THE SOVIET ECONOMY: CONTINUITY AND CHANGE 5 (M. Bornstein ed. 1981).

172. "The law on private economic activity, passed in November 1986 but put into effect in May 1987, allows individuals to engage in a broad range of hitherto illegal productive activities, including most services and handicrafts . . . workers employed in state industry can only do this on their off-hours . . . Any individual engaged in such activity must be licensed by legal governmental authorities (*ispol' komy*) and must pay either an annual income tax or an up-front fee (*patent*)." E. HEWETT, *supra* note 161, at 340. The right to own small-scale factories and other businesses was approved on March 6, 1990. Keller, *Soviets Approve the Right to Own Small Businesses*, N.Y. Times, Mar. 7, 1990, at A1, col. 3.

173. E. HEWETT, *supra* note 161, at 340.

operation in the Soviet Union, six times as many as a year earlier,<sup>174</sup> employing 5.5 million people.<sup>175</sup>

Although these cooperatives provide a variety of services, they are far from being universally popular. There is widespread resentment in the Soviet Union towards cooperatives for many of the same reasons there is resentment of private entrepreneurial activity in China. Cooperatives often charge high prices for their services and their members usually earn more than the average worker.<sup>176</sup> Furthermore, as a result of the new laws, *blat* (influence) or corruption increasingly has become widespread. Bureaucrats take bribes for extending favors to cooperatives while party bosses, judges, and other officials cooperate with racketeers to help private entrepreneurs eliminate competitors.<sup>177</sup>

Another aspect of Soviet privatization is "the human factor campaign," which includes worker incentives to increase productivity. This campaign has a "carrot and stick" aspect. The "stick" is an attempt to undermine the sense of security that workers have developed and is considered one of the great achievements of Soviet socialism. This approach, therefore, allows the most productive workers to earn many times the average ancestral wage of about 200 rubles a month.<sup>178</sup> In the past,

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174. "[A]ccording to official statistics, co-op sales increased from 350 million rubles in 1987 to 6.5 billion rubles in 1988. In the first quarter of 1989 sales were 43 million rubles." Kuteinikov, *The Emerging Soviet Private Sector*, N.Y. Times, Aug. 15, 1989, at A1, col. 3.

175. Keller, *Soviets Approve the Right to Own Small Businesses*, N.Y. Times, Mar. 7, 1990, at A1, col. 3.

176. A poll of Soviet citizens by the Soviet Public Opinion Research Center concluded that the Soviet reforms "are up against a deeply ingrained feeling of dependency on central government and a powerful distaste for letting some get richer than others." Keller, *Soviet Poll Finds Deep Pessimism Over Gorbachev's Economic Plan*, N.Y. Times, Nov. 5, 1989, at A1, col. 4. One commentator has noted:

A public opinion poll in the March issue of the Soviet magazine "20th Century and Peace," suggests that more than 86% of the population still holds an 'equal income' mentality. Since a co-op employee earns, on average, twice as much as a state industry workers (co-op managers, of course, make even more), the potential for resentment is real. The closing of all cooperatives was one of the demands of the Siberian coal-miners when they went on strike in July.

Kuteinikov, *The Emerging Soviet Private Sector*, N.Y. Times, Aug. 15, 1989, at A1, col. 3. "Public-opinion polls . . . indicate that most workers believe the state has an obligation to prevent some citizens from prospering while others fall behind." Keller, *Worry for Gorbachev*, N.Y. Times, July 26, 1989, at A1, col. 1.

177. See Keller, *Soviet Foray Into Capitalism Begins to Show a Seamy Side*, N.Y. Times, July 25, 1988, at A1, col. 1.

178. Mikhail Gorbachev has stated:

I think it is appropriate to draw your attention to one specific feature of socialism.

workers have had little incentive to work hard because there were so few goods available. The "carrot" is an attempt to provide more consumer goods through expansion of the portion of the economy devoted to consumer goods and the increased importing of foreign goods.

Hopefully, foreign enterprises operating inside the Soviet Union will provide some of these consumer goods, since, in 1987, for the first time since Stalin took power in 1924, the Soviet government began permitting foreign corporations to engage in joint ventures with Soviet enterprises. New legislation permitted foreigners to own 49 percent of the capital of the joint enterprise and to repatriate a small share of the earnings in hard currency. Representatives of both parties make management decisions.

Some agricultural proposals suggest that the state permit private farmers to lease state land for life and pass it on to their children.<sup>179</sup> Most recently, President Gorbachev has directed that private ownership of, and the right to freely transfer, houses and the land on which they are built be introduced by September 1990.<sup>180</sup>

## VI. CONCLUSION

China, as a result of its revolution, managed to house, clothe, feed, and provide medical care for one billion people. Within the short span of thirty years, China fashioned the "iron rice bowl," giving a formerly backward, semi-feudal population the security that its basic needs would be cared for.<sup>181</sup> Then, fearful that its economy was beginning to stagnate

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I have in mind the high degree of social protection in our society. On the one hand, it is doubtless, a benefit and a major achievement of ours. On the other hand it makes some people sponges . . . People are protected from the vicissitudes of life, and we are proud of this. But we also see that dishonest people try to exploit these advantages . . . they work poorly, shirk and drink hard . . . The policy of restructuring puts everything in its place. We are fully restoring the principle of socialism: "From each according to his ability to each according to his work."

M. GORBACHEV, *PERESTROIKA: NEW THINKING FOR OUR COUNTRY AND THE WORLD* 30-31 (1987).

179. See Keller, *Soviets to Allow Private Farmers to Lease State Land for a Lifetime*, N.Y. Times, Mar. 17, 1989, at A1, col. 1.

180. See Keller, *Soviets to Push Home Ownership*, N.Y. Times May 21, 1990, at A1, col. 5.

181. One commentator offers the following description:

[W]hatever the vicissitudes of the past thirty-five years, and even taking into account a major famine in the early 1960s . . . , China is no longer the international paradigm of mass destitution it was in the past. . . . In 1949 China was not only the most populous country, but among the poorest . . . the most basic 'good'—the expectation of survival until the next generation—was very unequally distributed,

as a result of the limitations of its highly centralized Soviet style economic system, China began in 1978 to introduce changes aimed at strengthening its legal system and giving markets and market-determined prices a greater role in allocating resources. Foremost among those changes were new laws privatizing land and other factors of production.

Privatization is bringing about a massive restructuring of property relationships in China. It is moving Chinese citizens into the realm of independent legal persons, dependent upon rights and duties, and away from China's historical emphasis on obligations and personal relationships. Privatization is creating a society of private rights and is attempting to nurture effective legal institutions. It is expanding the nature of private rights in employment, property, land transfers, inheritance, residential housing, domestic and foreign joint ventures, forms of business organizations, employee welfare benefits, trade unionism, intellectual property, and day-to-day market transactions.

Simultaneously, privatization is arousing unwanted obligations and fears. For the average citizen, personal income taxes, higher rents, dwindling job security, increased susceptibility to unemployment, a lower standard of living, declining worker entitlements, increasingly crowded cities, inadequate public services, school-imposed tuition, and a more polluted rural environment are outgrowths of economic reform through privatization. With privatization, workers have lost some of the protections they had under centralized economic control and are being subjected to the vicissitudes of the free market. Private contractual arrangements and local initiative are replacing cooperation, unified management, hierarchical structures, and central planning. Since the economic reforms began in 1978, output has increased, resources are better distributed, local ingenuity is reaping rewards, and the income of some has climbed; yet, corruption by government officials has grown, lawlessness appears to be on the rise, and greed and envy are common themes of Chinese life. There is little hope that resources will become available to fill the gaps in social services left vacant in the effort to privatize.

China, like other socialist societies, is accepting capitalist assumptions about human behavior and the economic structure that best compels ex-

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with a substantial section of the poorest men unable to reproduce itself.

C. RISKIN, *CHINA'S POLITICAL ECONOMY* 1, 26 (1987). "Only 25 years after Mao and his party captured national power, China had more than doubled agricultural production, raised industrial output by 20 times, kept population growth to about 60 percent, become a formidable military power, greatly reduced illiteracy, and virtually eliminated the threat of famine and most pestilence." J. GURLEY, *CHALLENGERS TO CAPITALISM* 156 (2d ed. 1979).

ercise of such tendencies. They have acknowledged the position that a person is likely to be more productive from a social as well as an individual standpoint if that person has the right to decide how best to dispose of the product of their labor. In the past, contrary to this belief, socialists traditionally have worked to prevent the waste and inefficiencies that result when individuals determine, without government interference, how to allocate resources.<sup>182</sup> Most accept as an article of faith that a socialist economy is superior at every stage of development to a capitalist economy, and that it promises faster growth and greater equality.<sup>183</sup> Many socialists place so high a priority on the goal of achieving equality that to reach this goal, they are willing "to pay even a high price in terms of immediate output or efficiency."<sup>184</sup> The socialists abhor profit maximization, which seeks to prevent competitors from gaining access to technological innovation, thus impeding growth. Socialists traditionally have been concerned with the quality rather than the pace of growth, since they believe that production in a market system responds to the easily manipulated whims of the wealthy rather than the basic needs and wants of the majority.<sup>185</sup> Ethically, they seek to reduce worker exploita-

182. There is no one universally accepted definition of socialism. Some emphasize collective ownership of the means of production: "The essence of socialism consists in the abolition of private property and creating in its stead collective or common property . . . by collective property is meant the abolition of individual or private ownership so that land, buildings, machines and all that has been produced by human hands may be used by all and for all." L. RECABARREN, J. JOBET, J. BARRIA, & L. VITALE, *OBRA SELECTAS DE LUIS EMILIO RECABARREN* 147 (1972). Others emphasize that "egalitarianism is the most fundamental principle of a socialist society organized on Marxian lines." P. SWEETZ & C. BETTELHEIM, *ON THE TRANSITION TO SOCIALISM* 122 (1971). Others sing in a more humanistic tone: "[T]he heart of socialism is to be found in the idea of community and in the doctrine that men can realize their full potential and achieve human emancipation in community," D. BELL, *SOCIALISM, THE INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL SCIENCES* 508 (1968).

183. Although many contend that the pure form of socialism is the proper economic model, many members of communist and socialist parties in Western Europe have favored "private property in the means of production, market incentives, and a meritocratic hierarchical society based on material incentives" and rejected "socialism of the means of production in any rapid or radical form." A. LINDEMANN, *A HISTORY OF EUROPEAN SOCIALISM* 322, 338-39 (1983).

184. P. SWEETZ & C. BETTELHEIM, *supra* note 182, at 133.

185. Engels, for example, wrote:

with the extension of the production of commodities, and especially with the introduction of the capitalist mode of production . . . producers were more and more turned into independent, isolated producers of commodities. It became apparent that the production of society at large was ruled by absence of plan, by accident, by anarchy, and this anarchy grew to great and greater height . . .

tion and the social cost attendant when markets dominate economic decisions.

In actuality, however, no pure market or purely centrally planned economy has ever existed, nor has there ever been an economy in which the state or the private sector has owned all the means of production. Rather, markets, central planning, and private and public ownership of the means of production may be found, albeit in different proportions, in all economies.<sup>186</sup> Even Lenin stressed all-embracing worker control over capitalists rather than confiscation of capitalists' property.<sup>187</sup> Therefore, it is understandable that China is experimenting with a spectrum of allocation mechanisms and ownership rights.

Privatization is one reflection of this experiment and of the fact that the socialist nature of China is changing or, in other words, that it is becoming more capitalist.<sup>188</sup> China, and other socialist regimes, increasingly are accepting the doctrine that economic growth alone is the measuring rod of success and have exchanged the socialist model and its emphasis on egalitarian distribution of income for one that measures success in terms of overall growth. They are defining ownership in legal terms that encourage privatization and a less egalitarian distribution of wealth. Prior ethical concerns about the distribution of resources and limiting private economic decisions are being replaced by a conviction that in a maturing, highly industrialized society, centralized planning and state ownership, while still ethically sound, are not effective for economic growth, and therefore a focus on output and efficiency is necessary, even if this entails turning state-owned property over to private individuals.

As the privatization process continues, however, China is encountering many of the same difficulties that Chile faced when it shifted from a centrally planned economic system to a market-oriented system, focusing

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F. ENGELS, *SOCIALISM UTOPIAN AND SCIENTIFIC* 60 (1935).

186. Even in the United States, the government taxes and regulates private activity in a variety of ways and produces, purchases from the private sector, and distributes many goods and services on its own. In 1981, for example, 12.1% of production in the United States was produced in the public sector, while 20.1% of output was provided through the government budget. R. MUSGRAVE & P. MUSGRAVE, *PUBLIC FINANCE IN THEORY AND PRACTICE* 9 (1984).

187. He stressed that organization and proper distribution of goods was crucial, and suggested that a fair tax could substitute for confiscation. Lenin, *Can the Bolsheviks Retain State Power*, in *THE LENIN ANTHOLOGY* 402 (R. Tucker ed. 1972).

188. "Yet a treatment of the essence of a socialist economy as being other than the social ownership of means of production would represent a definite breach with the tradition of socialist thought as this was inherited from the past century." M. DOBB, *WELFARE ECONOMICS AND THE ECONOMICS OF SOCIALISM* 123 (1978).

on individualistic economic decision making. Just as the shift in Chile was sudden, the result of a coup, the changes in China also are characterized by swift introductions of new economic policies without adequate trial or tests in one geographical area or sector of the economy.<sup>189</sup> The abrupt changes in both states have been marked by the glorification and accumulation of personal wealth. Corruption, social connections, and market opportunities are creating a class of wealth in China, just as they did in Chile, where assets that once belonged to workers ended up in the hands of a privileged class.

The Soviet Union's evaluation of the Chinese economic reforms has been sufficiently positive to engender a Soviet copy. The Soviet Union has had the advantage of being able to observe the preliminary outcome of China's reform, and therefore has been able to take steps to avoid some of the difficulties encountered by the Chinese. As such, Soviet choices serve as a mirror to highlight the shortcomings of the Chinese effort.

The Soviet Union is being more cautious than China in its privatization effort. It has introduced democratic political reforms to complement its economic programs. There is more open debate about the possible consequences of *perestroika* or economic restructuring. This debate is causing the Soviet Union to move more slowly and carefully than did China.

While China's stress on the necessity of a few people acquiring great wealth before others has produced conflict and envy, the Soviet Union's attempts at reform are characterized by a decision to place less emphasis on the glorification of private wealth. The focus primarily is on reform of the wage system and an effort to provide more consumer goods, rather than the propaganda value of extolling individual incentive. The Soviet

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189. While China's experimentation with Special Economic Zones (SEZs) can be viewed as attempts to test its new economic programs, they clearly were different for a number of reasons. Perhaps, in an attempt to avoid having to apply new policies to existing state enterprises, SEZs were intended as innovative creations, put down in virgin locations, usually geographically close to areas in which socialist policies had the weakest hold, and in fact largely were failures from which it would have been reasonable to conclude that related economic reforms, especially those that would operate on a national level and in areas where central control was strongest, were doomed to difficulty, if not failure.

In most respects, the SEZs have been a dismal failure. Moreover, they have bolstered resentment over individuals enriching themselves, become a source of illicit foreign exchange transactions, and encouraged outright fraud. See Pepper, *China's Special Economic Zones: The Current Rescue Bid for a Faltering Experiment*, 20 BULL. CONCERNED ASIAN SCHOLARS July-Sept. 1988, at 2; see also Klitgaard & Rasmussen, *supra* note 32.

Union also has been more reluctant than China to disregard its commitment to equality since socialist ideals have been established over a longer post-revolutionary period and seem more engrained in the Soviet Union.

China in turn, could learn more than it has from privatization in Chile and from the Soviet Union's cautionary reactions to the reforms in China. China needs to place more emphasis on the long-term impact of privatization. For example, rural households in China have thus far seen their incomes rise primarily as a result of the privatization of rural farmland and deregulated prices for agricultural products. But rural gains largely have resulted from shifting the burden of inflation to urban households which are more susceptible to the rise in prices of consumer goods, especially food and shelter.

The rural income gains likely are to be short-term. Privatization already has begun to mean uncertainty concerning the cost of agricultural inputs and machinery, along with fluctuating prices for farm products. Furthermore, it is only over a longer period of time that the decline in social welfare benefits, health care, and education, the return of child labor in rural areas, the burdens of environmental pollution, the lack of collective action, and the reduction in communal capital investment, especially in projects such as irrigation and erosion control, will have their full impact. Moreover, it will take years for the continued government actions that allocate a disproportionate amount of state resources and employee benefits to favored urban areas to fully affect the countryside.

Privatization brings with it many other uncertainties. For instance, the contract system is in its formative stages. It is impossible to forecast accurately how many contract workers will become unemployed when their employment contracts are not renewed. Will state enterprises and other employers adopt a revolving door approach and hire younger, more eager workers as low wage replacements for older workers at the numerous low and semi-skilled jobs that permeate the Chinese economy? Even the outcome of these relatively mundane steps towards privatization is difficult to predict. For example, the decline of rural collectivization, coupled with the contracting of farmland to families and small collectives, and the encouragement of new home construction, resulted in a loss of valuable acreage through the building of houses on land contracted for farming.<sup>190</sup> This, in turn, had to be constrained by regulations specifically intended to control building on cultivable land.<sup>191</sup>

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190. The usurpation of arable land for home construction has been widely noted and is evident even to an observer concerned with extolling the recycling of resources in rural China. Jervis, *Waste Not, Want Not*, NATURAL HISTORY May 1990, at 70.

191. Regulations on the Administration of the Land for Building Houses in Villages

The basic trade-off that Chinese socialism offered workers—guaranteed low wages and secure benefits in return for acceptance of boring, repetitive, yet tension-free work—because of surplus employees and downtime caused by ineffective planning and material allocations, has been replaced by an employment relationship comprised of private contractual rights, management's power to control overstaffing, the risk of unemployment, and the potential for labor unrest. China seems willing to accept the risk that this privatization of employment relationships and redistribution of wealth will undermine the social fabric and lead to political unrest.

China also seems ready to accept the risk that privatization will outpace reforms in its legal system. Changes in the legal system to legitimize privatization efforts have been effective in some areas, such as inheritance and long-term rental of agricultural land for farming and home construction. The Chinese, however, retain a nurtured distrust of the legal system and its misuse as a tool of national political policy. It is precisely this lack of faith in normal legal institutions as means of redress for private property disputes that will continue to encourage Chinese citizens to cling to less formal, extra-judicial forms of dispute resolution. This dependence places a further constraint on government efforts to privatize, since it provides additional motivation for workers to remain linked to state-run enterprises and to petty Communist Party officials who serve as representatives in resolving such disputes.

It also is doubtful that the Chinese legal system can adapt effectively to protect private rights and act in any way to restrain the accumulation of private wealth. Furthermore, addressing questions of unemployment, worker dissatisfaction, expanding trade unionism, and providing administrative sanctions for the provision of job security for contract workers, are beyond the Chinese legal system's current capabilities.<sup>192</sup> A legal system that cannot cope with petty corruption, widespread tax avoidance, and enforcement of existing price regulations simply is not viewed as effective. The populous will continue to perceive favoritism, loss of economic security, and corrupt practices as extensions of the legal institutions that are entrusted with power by the Chinese government.

Undoubtedly, China will be compelled, perhaps through the threat of social unrest caused by growing income inequality and loss of social wel-

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and Towns (1982), *reprinted in COMMERCIAL LAWS, supra* note 72, at 145.

192. For example, although it hardly is adequate, the government is implementing unemployment insurance for urban factory workers who have lost "iron rice bowl" security, while rural workers who have lost the protections provided by communes are not being included in this program. Josephs, *supra* note 81, at 248-49.

fare benefits, to move more slowly in its progression towards privatization and freer markets. It will have to retreat to a mixed economy and allow the regulatory power inherent in Chinese socialism to propel the economy at reasonably high growth rates, while maintaining the goal of equitable income distribution and a modicum of social benefits. Inevitably, China will continue to search for a way to evolve into that elusive fictional entity that simultaneously can respond to market prices and maximize social welfare.