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## Individual Enterprise in Contemporary Urban China: A Legal Analysis of Status and Regulation††

Since 1978 the People's Republic of China has been introducing fundamental economic reforms that have attracted worldwide attention. The aim of economic reform is, by a process of allowing the economy to respond to market forces and upgrading technology, to increase the supply and quality of agricultural produce, manufactured goods, and services so as to satisfy the demands of China's 1.03 billion people. These reforms began in rural areas, first in the agriculture and then in the tertiary sector. In 1984 the Government adopted an overall policy to make similar reforms to the urban economy.

Encouragement of private enterprise is an important part of these economic reforms. In rural areas the contract production household has replaced the commune as the most fundamental unit in agriculture. In both rural and urban areas another economic phenomenon has emerged: the "individual industrial and commercial enterprise."<sup>1</sup> Individual enterprise

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††The Editorial Reviewer for this article is Larry D. Johnson.

1. *Geti gongshang hu*, hereinafter referred to as *individual enterprise*. This translation has been chosen from a number of possible but imperfect translations. It is hoped this translation will capture two important elements, namely, that an individual enterprise is regarded as a distinct business entity usually carried on either by an individual or an entire household. *Enterprise* is thus used in its original sense, that is an unincorporated business association, not in the sense of a *giye*, which in modern Chinese law is a corporation but is frequently mistranslated as "enterprise." It should also be noted that the Chinese term

means a person, with or without the participation of family members, who engages in an ever-growing range of activities in light industry, commerce, or service trades. By the end of 1985 China boasted over twelve million registered individual enterprises, of which over one-third were in urban areas, engaging almost 18 million people.

From 1978 to 1982 individual enterprises accounted for 75 percent by number of new establishments in commerce, food, and beverage as well as other service trades.<sup>2</sup> In 1985 individual enterprises engaged in commerce accounted for 18 percent of total national retail sales.<sup>3</sup> China's new economic policies have shifted ideological emphasis from flagging collective enthusiasm to fresh individual initiative, leading some analysts to believe that China is experimenting with private enterprise as a model for transforming the public economy. Despite a rapid growth in their numbers and the diversity of their trades, individual enterprises are not intended to replace state and collective enterprise;<sup>4</sup> already, however, they serve as an important supplement to commerce and service trades neglected by the public sector.

The Chinese closely monitor the economic performance of individual enterprise and despite some recent setbacks<sup>5</sup> they view its performance as an overall success. This has led to further and more recent measures that stimulate individual initiative in the public sector, notably the system of "leasing" the publicly owned means of production in state and collective enterprises to individual employees.<sup>6</sup> Ultimately, these new roles for the individual in the public economy may have far-reaching effects on China's economic system and political ideology. They must, however, await further legal analysis.

The economic phenomena that have emerged from these reforms have their expression in China's developing legal system, particularly in the General Provisions of Civil Law.<sup>7</sup> Individual enterprise is one such phe-

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has itself undergone considerable change. This and related terms are defined and explained *infra* at text section III.

2. BUSINESS HANDBOOK FOR INDIVIDUAL INDUSTRIAL AND COMMERCIAL ENTERPRISES IN URBAN AND RURAL REGIONS 5 (Yu Ruhai & Zhang Yi eds. Guizhon People's Press 1985) [hereinafter BUSINESS HANDBOOK].

3. China Legal News, May 9, 1986.

4. Although gross output value of individual enterprise in the industrial sector increased 150 percent in 1985 this accounted for only 3.8 billion yuan or less than 0.5 percent of China's total gross industrial output. FAR EASTERN ECON. REV., Mar. 20, 1986, at 81.

5. See *infra* text section II.

6. See *infra* note 92.

7. General Provisions of Civil Law, People's Daily, Apr. 17, 1986 [hereinafter Civil Law]. Although not yet a complete civil code in the accepted sense, they are the first attempt to codify civil law in the People's Republic of China. An English translation appears in 34 AM. J. COMP. L. 715 (1986).

nomenon, and this article examines its status and regulation as a legal expression of economic reform.

## I. Historical Background

Private enterprise has taken a tortuous course since the founding of the People's Republic of China. Its form and scale have changed from one period to the next in accordance with prevailing political, economic, cultural, as well as legal, conditions. An historical review of these conditions is therefore essential to our understanding of the current legal status of the individual enterprise.

### A. 1949 TO 1952

Before 1949 private enterprise existed in many forms, and at the end of 1949 over seven million persons were engaged in individual enterprise in towns and cities, mainly in small scale commerce and manufacturing trades.<sup>8</sup> Immediately thereafter, the Government in addition to establishing a new economic order based on public ownership, also developed and encouraged private enterprise. At that time the legal basis of individual enterprise was to be found mainly in China's provisional "constitution," the Common Programme.<sup>9</sup> It provided that "under the leadership of the public economy" state, collective, cooperative, and private capitalist enterprise should all play their roles "to promote the development of the economy as a whole."<sup>10</sup> Further, the state "should encourage and assist any private economic endeavor which is beneficial to the national economy and the people's livelihood."<sup>11</sup>

Under conditions conducive to growth, therefore, by 1952 the total number of persons engaged in individual enterprise in towns and cities had increased to almost nine million or 1.5 percent of China's total population.<sup>12</sup> In the same period their contribution to industrial output more than doubled.<sup>13</sup> This development was itself conducive to social stability and generally stimulated economic growth.

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8. See Liang Chuanyun, *Development of Individual Enterprise in China*, in 1984 ECON. Y.B. OF CHINA IV-51.

9. *Common Programme of the Chinese People's Political Consultative Conference*, in 1 DIGEST OF LAWS AND DECREES OF THE CHINESE CENTRAL PEOPLE'S GOVERNMENT 17.

10. *Id.*

11. *Id.*

12. 1984 STATISTICAL Y.B. OF CHINA 81.

13. *Id.* at 194.

## B. 1953 TO 1956

The first five-year plan was adopted in 1953. It introduced a program of industrialization and socialist transformation of agriculture, manufacturing industry, and commerce, the primary objective of which was to establish a socialist economic system based on public ownership of the means of production. This new economic policy was reflected in the 1954 Constitution.<sup>14</sup> In this period transformation of individual enterprise was dealt with on two fronts. First, in a movement to organize individual manufacturing trades into cooperative and collective forms of economic association, the latter were given special support and assistance in respect of investment capital, taxation, supply of raw materials, and product sales. As a result, from 1953 to 1956 the total number of persons engaged in individual manufacturing trades dropped from almost four million to only 80,000.<sup>15</sup> Secondly, in the same period and with an essentially identical approach, persons engaged in individual commerce and service trades were reduced from over three million to only 80,000.<sup>16</sup> In this way, by the end of 1956 more than 95 percent of all individual enterprise had been transformed into cooperative economic associations.<sup>17</sup>

As was later recognized, however, the speed and intensity of socialist transformation in this period had its "shortcomings and errors."<sup>18</sup> In 1981 the Chinese Communist Party adopted a resolution on its history since 1949 that described this period as "*over hasty* in pressing on with agricultural cooperation and the transformation of private manufacturing and commercial enterprise. We were far from meticulous, *the changes were too fast* and we did our work in a somewhat summary, stereotyped manner, *leaving open a number of questions* for a long time."<sup>19</sup> As we will see below, two of these questions were the ability of private enterprise to create employment and to respond to demand for goods and services neglected by the public sector.

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14. "From the founding of the People's Republic of China to the establishment of socialism is the transitional period. In this period the State's general duties are to realize socialist industrialization and gradual socialist transformation of agricultural, handicraft trades and capitalist commerce." 1 DIGEST OF LEGAL REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA 5.

15. 1984 STATISTICAL Y.B. OF CHINA 194.

16. Due to the development of the public economy, however, there was an increase in the proportion of individual enterprise in total industrial output from 3.22 billion yuan in 1949 to 7.06 billion in 1952. *Id.* at 94.

17. Liang Chuanyun, *supra* note 8.

18. Resolution on Certain Questions in the History of Our Party Since the Founding of the People's Republic of China, adopted by the Sixth Plenary Session of the Eleventh Central Committee of the Chinese Communist Party, June 27, 1981, at 21 (Foreign Languages Press 1981) (English ed.).

19. *Id.*

## C. 1957 TO 1966

The excesses of the "transitional period" were already recognized in a speech delivered by Chen Yun at the First Session of the Eighth Central Committee of the Chinese Communist Party in 1956<sup>20</sup> and resulted in a relaxation of control over individual enterprise that lasted from 1957 to 1966. Despite economic policies associated with the "Great Leap Forward," which in any case focused on economics in the countryside, by the end of 1958 the total number of persons engaged in individual enterprise had increased to about one million,<sup>21</sup> and hovered around this figure until 1961.

In the aftermath of economic failure caused by the "Great Leap Forward" the new decade saw the adoption of a series of policies designed to promote individual enterprise. For example, in 1961 the Central Committee adopted a long set of trial regulations for the handicraft industry,<sup>22</sup> stipulating that private ownership was one of three types of legitimate ownership in China. Further, it provided that cottage handicraft industry was a legitimate part of all industry that could be developed in a number of different forms. The regulations clearly designated income from handicraft industry as private property under the control of the individual. Compared with the 1954 Constitution, these provisions were far more detailed and practical to enforce. Similar provisions were made for individual commerce, and together they constituted a legal basis, in the form of Party policy, for individual enterprise. From 1961 to 1964, then, the total number of persons engaged in individual enterprise increased from 1.65 million to 2.27 million persons.<sup>23</sup>

## D. 1966 TO 1976: THE GREAT PROLETARIAN CULTURAL REVOLUTION

In principle the 1954 Constitution was valid throughout the "Cultural Revolution," but in practice political movements and economic policies denigrated individual enterprise as "the tail of capitalism," with the result that individual enterprise was almost entirely removed from the economic system. Persons engaged in individual enterprise dropped from over one and a half million in 1966 to less than 200,000 persons in 1976.<sup>24</sup> In fact, despite a partial reversal of economic policy before the death of Premier

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20. Liang Chuanyun, *supra* note 8.

21. 1984 STATISTICAL Y.B. OF CHINA 122.

22. Certain Regulations Concerning Policy Issues of Handicraft Trades in Towns and Cities (Trial Draft), Central Committee of the Chinese Communist Party, June 19, 1961 in SELECTION OF ECONOMIC LAW MATERIALS 118 (Beijing Institute of Political Science and Law 1982).

23. 1984 STATISTICAL Y.B. OF CHINA 122.

24. *Id.*

Zhou Enlai in 1976, the numbers of individual enterprises continued to decrease until 1978.<sup>25</sup>

#### E. 1978 TO THE PRESENT

Current policies about individual enterprise stem from the Third Plenary of the Eleventh Central Committee of the Chinese Communist Party, which took place in the autumn of 1978. This meeting represented a significant shift in policy from class struggle to modernization and broke away from the ideal of a "big, public, and pure" system of ownership that characterized the economic policies of the "Cultural Revolution." It was the starting point for current economic reforms and has led directly to the revival and enormous increase in individual enterprise in China today. Current economic reforms began in the countryside where the communization of agriculture had created a three-tiered system of collective ownership (commune, production brigade, and production team). This system was gradually broken down by the introduction of a contract production system based on ownership by peasant families. According to this so-called "production responsibility system" households rather than teams of agricultural workers make a production contract (*tudi chengbao*) to produce a certain quantity of agricultural produce by using the land and sometimes the farming implements owned by the collective.<sup>26</sup> In the beginning most households grew mainly staple crops and "sideline produce" such as poultry or cash crops, but the "specialized household" (*zhuan yehu*) soon developed and the sideline became its principal or only produce.<sup>27</sup> Finally, some specialized households left agriculture altogether to invest in handicraft industry, commerce, and service trades.

The success of rural reforms thus became a model for towns and cities. Since 1979 the State Council has issued a series of policy documents designed to develop individual production, commerce, and service trades in urban areas. This trend culminated in the promulgation of Certain Policy Regulations Concerning Non-Agricultural Individual Economics in Cities and Townships by the State Council in July 1981.<sup>28</sup> The preamble clearly provides that

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25. *Id.*

26. For the purposes of this discussion we wish only to introduce the emergence of the rural contract business household. As for the demise of the commune, due to the economic rigidity that resulted from combining both economic and administrative functions within the commune structure it was not possible to tap the initiative of agricultural workers, with the result that they all "ate from the common pot." See generally LUO HANXIAN, *ECONOMIC CHANGES IN RURAL CHINA* 81, 140, 154 (New World Press, Beijing 1985) (English ed.).

27. Standard Form Contract for Rural Specialized Households, *People's Daily*, Nov. 5, 1985.

28. Certain Policy Regulations Concerning Non-Agricultural Individual Economy in Cities

under Our Country's socialist conditions, obeying state policy and law to serve socialist construction, individual economy which does not exploit other workers is a necessary supplement to state and collective economies. Further, experience has proven that under the premise of absolute superiority of state and collective economies, the revival and development of the individual economy has great significance for the development of production, enlivening the marketplace, satisfying the daily needs of the people and creating employment.

Despite the twists and turns in China's economic development, policy concerning individual enterprise has remained tied to economic policy as a whole and has thus been the subject of policy documents and legal regulation. Although current policies and laws carry a familiar ring when compared with those of the 1950s and early 1960s, the quality and degree of current legislation, as set out in detail below, far exceeds earlier provisions.

## II. The Current Situation

Unemployment and deficiencies in the supply of goods and services are two major considerations behind the current policies to stimulate individual enterprise. Although China rarely publishes unemployment statistics, it is not difficult to glean from writings on current economic problems that job creation is a serious issue, particularly for school leavers.<sup>29</sup> Deficiencies in the supply of goods and services, however, are well recognized, and new policies of economic reform are designed to develop further China's backward tertiary sector.<sup>30</sup> Solutions to these two problems are being found within the framework of current socialist ideology, and a careful distinction has been drawn between the current policy to stimulate individual enterprise and the earlier policy to tolerate the remnants of capitalism after 1949. This section introduces the principal sources of law that reflect these policies; it also examines the main features of individual business activities and some important aspects of their economic performance.

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and Townships, State Council, July 7, 1981 [hereinafter National Policy Regulations], in *SELECTION OF LAWS AND REGULATIONS ON NON-AGRICULTURAL INDIVIDUAL ECONOMY* 9 (Workers' Press 1982).

29. It is beyond the scope of this discussion to trace the economic causes of unemployment in China. The classic cause of rural unemployment in a developing country, that is, the shift of its economic base from agriculture to industry, is not necessarily related to Chinese urban unemployment because a strict system of residential registration prevents most rural migration which would create an oversupply of workers in urban areas. The stimulation of individual enterprise is not the only current method of relieving urban unemployment. Collectives, too, have created employment by establishing subsidiary "service companies" engaged in light industry and commerce.

30. See Zhang Xianming, *Actively Support the Strong Development of Tertiary Industry*, in *URBAN ECONOMIC REFORMS* 120 (Pu Mingqian ed., Liaoning People's Press 1985).



China's 1975 and 1978 Constitutions included almost identical provisions that made supposed guarantees to individuals engaged in private enterprise. Not until 1981, however, was a series of regulations promulgated that crystallized the new policies towards individual enterprise into law. The first set of national regulations took as their premise "that the restoration and development of the non-agricultural individual economy in cities and townships has great significance for the development of production, enlivening the marketplace, satisfying the daily needs of the people and creating employment."<sup>31</sup> Conspicuously absent from these and similar local regulations was the then ominous constitutional provision that individual enterprise would "gradually walk the path of socialist collectivization." This provision was removed from the 1982 Constitution.<sup>32</sup>

Similar provincial legislation preceded the National Policy Regulations by only a few months, notably a quite thorough set of twenty rules adopted by the Liaoning Provincial Government,<sup>33</sup> and were followed by supplementary regulations in 1983<sup>34</sup> as well as much more local legislation. This article cannot hope to survey all legislation on individual enterprise. Instead it focuses on the two sets of national regulations, the early regulations in Liaoning Province, and a new set of regulations recently adopted in Wuhan, the capital of Hubei Province.<sup>35</sup>

#### A. TRADES PERMITTED TO INDIVIDUAL ENTERPRISES

The National Policy Regulations and most local laws provide a nonexhaustive list of seven trades (*hangye*) in which individual enterprises may engage.

31. National Policy Regulations, *supra* note 28, preamble.

32. CHINA CONST. art. 11 (1982) provides that "individual economy of urban and rural working people, within the limits defined 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."

33. Trial Measures for the Administration of Individual Commercial, Service and Manufacturing Enterprises in Liaoning Province, Feb. 16, 1981 [hereinafter Liaoning Measures], in SELECTION OF LAWS AND REGULATIONS ON NON-AGRICULTURAL INDIVIDUAL ECONOMY 98 (Workers' Press 1982).

34. Supplementary Regulations to "Certain Policy Regulations Concerning Non-Agricultural Individual Economy in Cities and Townships," State Council, Apr. 13, 1983 [hereinafter Supplementary Regulations] in SELECTION OF ECONOMIC REGULATIONS (1977 to 1984) 104 (Heilongjiang Law Research Centre 1984).

35. Provisional Regulations for the Administration of Individual Commerce in Wuhan City, June 26, 1985 [hereinafter Wuhan Regulations], in 1 LATEST ECONOMIC LEGISLATION 386 (Mechanical Engineering Press 1985).

### 1. Commerce

Commerce (*shangye*) is clearly the largest field of individual enterprise both in terms of the number of persons engaged in commercial activities and of total turnover. The term commerce encompasses the sale of agricultural as well as manufactured goods.<sup>36</sup> Such goods include small household articles (such as toiletries, wicker goods, bicycle parts), various processed food items, cigarettes, liquor, cakes and pastries, various local specialty produce (such as mushrooms, sauces, and spices), dried and fresh fruits, vegetables, aquatic produce, poultry and eggs, old or other discarded articles (not including metallic wastes), and so on. Most individual commerce consists of retail sales. Some wholesaling and a practice of selling wholesale quantities at retail prices (*pi ling*) is permitted (or tolerated), however, and as will be discussed below, individual enterprises are taxed accordingly.<sup>37</sup> Commerce in China now includes *fanyun*, that is the transport of goods to market by the grower, manufacturer, or even a middleman for direct sale to the consumer. *Fanyun* was once considered a crime of economic speculation, but today it is regarded as a good example of coordination between rural and urban economic reforms. It allows rural production households to sell agricultural produce and manufactured goods directly to the consumer in towns and cities, thereby avoiding bottlenecks in the public system of transport and distribution.

National figures show that commerce accounts for over 50 percent of individual enterprises registered in urban and rural areas.<sup>38</sup> On a national average less than 5 percent are engaged in *fanyun*, but this proportion may vary dramatically according to local conditions.<sup>39</sup> Figures also show that the proportion of individual retail commerce in the national total has grown from 0.1 percent in 1978 to 18 percent in 1985.<sup>40</sup> Nevertheless, the number of registered households engaged in commerce appears to be falling in proportion to other trades.<sup>41</sup>

36. See, e.g., the extensive list given in the Liaoning Measures, *supra* note 33, § 6.

37. The Supplementary Regulations, *supra* note 34, provide that individual enterprises may wholesale only to complete the state plan for certain goods, notably agricultural produce and three types of small commodities.

38. See Figure B. Compared with other individual enterprise activities, individual commerce may account for an even higher proportion of total turnover. In Benxi City Liaoning Province, for example, 1984 retail sales accounted for almost 70 percent of total turnover. *Quality and Quantity Must Harmonize in the Rate of Development of the Individual Economy in URBAN ECONOMIC REFORMS*, *supra* note 30, at 124.

39. For example, it has been reported that in Chongqing (a major industrial city in agriculturally rich Sichuan Province) 45 percent of individual enterprises are engaged in *fanyun* from the suburbs and surrounding countryside. People's Daily, Mar. 18, 1986.

40. China Legal News, May 9, 1986.

41. See Figure B.

## 2. Food and Beverage

Food and beverage (*yinshiye*) is the second most common trade. It includes activities that may be viewed as services, such as restaurants and public houses, or as retail sales, such as hawking ice creams, drinks and sweets. Examples that combine both service and retailing are the cooked food stalls set up to serve a variety of local and regional snack cuisine. Like individual commerce, food and beverage trades appear to be falling in proportion to other trades, probably because public health controls are relatively strict and business premises difficult to find. This decline is certainly not for want of demand, however, as even casual observation of restaurants and food hawkers in major cities reveals. In March 1986 a Shanghai "snack market," which was to be held for six days coinciding with a traditional festival, was closed after only three days because of the uncontrollable crowds it attracted.<sup>42</sup>

## 3. Repair

Repair trades (*xiuliye*) meet another consumer demand badly neglected by the public sector. China is not a "throw-away" society, so most durables have a much longer depreciable life than in developed countries. Repair services are therefore an important aspect of individual enterprise. Again, casual observation is enough to indicate the trends: a predominance of bicycle repairers (not surprising for a country that produces about 30 million bicycles a year), followed closely by shoe and accessory repairers. Repair trades also include watch, spectacle, zipper, and lock repairs, as well as repairs to household appliances and furniture.

## 4. Other Services

Other service trades (*fuwuye*) include haircutting, photography, laundry, tailoring and mending, knife and scissors sharpening, wall painting, key cutting, seal carving, teasing cotton for winter bedding, the rental of rooms in hostels, billiards and book rental, medical practice, and recently, even a small telephone exchange in Beijing. These sundry services have been separately designated and account for about the same proportion of the total as do the repair trades. In 1982, food and beverage, repair, and other service trades accounted for 40 percent of the total number of persons engaged in individual enterprise in towns and cities.<sup>43</sup> For various reasons, most importantly population density, this proportion is likely to be much

42. At the Mid-Autumn Festival crowds swelled to almost half a million people, and 1,400 police were called in to keep order. China Daily, Mar. 27, 1986.

43. REVIEW OF ECONOMIC POLICIES AND LEGISLATION SINCE THE THIRD PLENARY SESSION OF THE ELEVENTH CHINESE COMMUNIST PARTY CONGRESS 62 (Wang Zhengming Law Press 1984).

lower in rural areas. This probably explains why the aggregate of all service trades in both rural and urban areas in 1983 is proportionally lower by about 11 percent.

### 5. *Transport*

Transport (*yunshuye*) services were originally confined to nonmotorized forms of transport such as horse and donkey carts, trishaws, and hand-drawn carts for goods only.<sup>44</sup> The Supplementary Regulations later provided that "subject to specific local conditions" individuals may also use motorized vehicles and boats for the transport of goods and passengers.<sup>45</sup> Transport services appear to have grown almost as fast as commerce, but probably due to local conditions and high capital outlay they still account for less than ten percent of all seven principal trades.

### 6. *Small Scale Handicrafts*

Small scale handicraft trades (*shougongye*) accounted for over 15 percent of all persons engaged in 1984. They manufacture a wide variety of products, including knitted and woven cloth and clothing, children's toys, embroidery, and other handicrafts, as well as necessities such as kitchen implements. Rural household manufacturing workshops in Guizhou Province accounted in 1984 for more than half of rural industry. Their combined output value of 633 million yuan (U.S. \$192 million) was 160 percent more than in 1983.<sup>46</sup> At the same time, rural household workshops employing 3.5 percent of Zhejiang Province's rural workforce accounted for 11 percent of the total rural industrial output in this economically advanced and populous area.<sup>47</sup> In urban areas, however, manufacturing trades probably account for a much smaller proportion of individual enterprise.<sup>48</sup>

### 7. *Housing Maintenance*

Housing maintenance (*fangwu xiushanye*) is the last of the seven trades designated by the National Policy Regulations. It was not mentioned by

44. National Policy Regulations, *supra* note 28, § 1; Liaoning Measures, *supra* note 33, § 6(6).

45. Supplementary Regulations, *supra* note 34, § 1.

46. China Daily, May 2, 1985.

47. China Daily, Jan. 30, 1985.

48. In 1984 only 12.6 percent of all urban individual enterprises were engaged in "industry." 1985 ECON. Y.B. OF CHINA V-257. In an area of Beijing we surveyed, manufacturing trades accounted for less than four percent of total individual enterprises. In 1984 the urban average for Beijing was 6.7 percent as compared with the rural average of 17 percent. 1985 BEIJING SOCIAL STATISTICAL Y.B. 389. Note that these proportions vary dramatically according to local conditions. For example, in 1984 nine townships under the administration of Wenzhou City, Zhejiang Province were reported to have absorbed half of their 800,000 surplus labor force into individual manufacturing industries. China Daily, Jan. 30, 1985.

the Liaoning Measures, yet despite the fact it accounted for less than half a percent of all individual enterprises in 1984, it was still included in national statistics and appears again as a designated trade in the recent Wuhan Regulations. Perhaps housing maintenance earns special treatment because it is more "collective" in nature than other trades. In 1984 an average of about five persons for every household engaged in housing maintenance, by far the highest average amongst all seven trades.<sup>49</sup>

## B. INDIVIDUAL ENTERPRISE'S EFFECTS ON UNEMPLOYMENT

By the end of 1985 individual enterprise had engaged almost eighteen million persons (an almost thirty-fold increase since 1978), about one-quarter of whom traded in towns and cities.<sup>50</sup> The new employment opportunities thus created have been significant. In the interests of social stability there is a special need to find jobs for unemployed youth, the large part of whom are school leavers, but large numbers of unskilled workers are difficult to absorb into the workforce on an annual basis. From 1978 to 1983, however, individual enterprise absorbed more than half a million unemployed urban youth<sup>51</sup> and at the same time the proportion of urban youth engaged in individual enterprise rose from nine percent to over 28 percent.<sup>52</sup> In Beijing, Guangxi, and Jiangxi provinces, urban youth accounted for more than 40 percent.<sup>53</sup> In 1984, however, despite a 20 percent increase in real numbers, the proportion of urban youth engaged in individual enterprises decreased by one percent.<sup>54</sup>

Individual enterprise has also absorbed some retired persons,<sup>55</sup> but the greatest impact on unemployment in towns and cities has been the absorption of almost two million "idle persons" who in 1984 accounted for over two-thirds of all urban individual enterprises.<sup>56</sup> Unfortunately, Chinese statistics do not define "idle persons." By distinguishing between three categories of the unemployed, however, we can deduce that "idle per-

49. See Figure B. Five was also the average number of persons per household engaged in housing maintenance in the area we surveyed.

50. The figure of 17.6 million persons was released by the New China News Agency in January 1986.

51. The figure was 581,000 persons or 1.3 percent of new urban workforce in that five year period, 1984 ECON. Y.B. OF CHINA IV-51 to 53 (percentage calculated on the basis of total figures in 1984 STATISTICAL Y.B. OF CHINA 130).

52. *Id.*

53. *Id.*

54. *Id.*

55. In 1984 they accounted for 5.3 percent of total persons engaged in urban individual enterprise in towns and cities. The policies behind encouraging retired persons to enter into individual enterprise are discussed *infra* text accompanying notes 95-96.

56. In 1984 there was a slight fall in this proportion, however, from 68 percent to 67.4 percent. Liang Chuanyun, *supra* note 8.

sons" are young persons who have either left their employment or who have not yet entered the workforce for other reasons. The latter would include former detainees of prisons and institutions for reform or education through labor,<sup>57</sup> but statistics are silent on the proportion of such persons in the whole category.

In 1983 the impact of individual enterprise on employment in towns and cities was significant, absorbing 13.4 percent of all newly employed persons.<sup>58</sup> The effect on rural employment has been even greater. In 1983 five percent of the total rural work force was engaged in individual enterprise.<sup>59</sup> The pace of development in rural areas has also far surpassed that in towns and cities. Total persons engaged in rural individual enterprise increased 450 percent in two years, from 1982 to 1984. By way of contrast, the increase in towns and cities was only about 100 percent.<sup>60</sup> Local statistics appear to support this trend. For example, persons engaged in individual enterprises in the rural outskirts of Beijing increased almost 80 percent in 1984, as compared with a mere 15 percent increase in the capital's urban areas.<sup>61</sup> Despite remarkably high growth of individual enterprise in recent years, the growth rate has responded to market conditions. A general slowing down in the growth of urban individual enterprise in 1983, for example, has been attributed to a combination of factors. Firstly, more opportunities became available in urban collective enterprises and, secondly, the cost of getting established was high and there were problems finding a suitable place to carry on business.<sup>62</sup> The reasons for more recent developments, however, may require different explanations. After growing about 52 percent nationally in 1985, the first half of 1986 showed a decline in individual enterprise for the first time since 1977.<sup>63</sup> Although public figures have not been consistent,<sup>64</sup> they seem to point to a saturation in some trades,<sup>65</sup> notably commerce, and

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57. The Supplementary Regulations § 4 clearly provides that subject to ordinary preconditions both these types of past offenders may apply for a business license. Supplementary Regulations, *supra* note 34, § 4.

58. 1984 STATISTICAL Y.B. OF CHINA 130.

59. Liang Chuanyun, *supra* note 8. This figure does not include rural contract business households.

60. *Id.*

61. 1985 BEIJING SOCIAL STATISTICAL Y.B. 389.

62. Liang Chuanyun, *supra* note 8.

63. People's Daily, Oct. 4, 1986 (overseas ed.).

64. The People's Daily (overseas ed.) reported a fall of 360,000 individual enterprises and 460,000 persons nationwide in the first half of 1986 (*supra* note 63) but the figures in the China Daily were only 190,000 and 210,000 respectively, September 16, 1986.

65. Notably, commerce (47,000 shops closed in urban areas and 144,000 shops closed in rural areas), miscellaneous service trades (down 17,000 enterprises) and repair services (down 6,000 enterprises); food and beverage trades, however, increased by 6,000 enterprises, China Daily, Sept. 16, 1986.

the inability of the centrally planned economy to accommodate the individual economy.<sup>66</sup> Also, the wanton levy of fees and charges by administrative departments is reported to be a factor related to the decline.<sup>67</sup> The Chinese press has stressed, however, that the decline is not attributable to a change in economic policy.<sup>68</sup>

### C. TENTATIVE CONCLUSIONS ON ECONOMIC PERFORMANCE

Statistics are merely a guide not an absolute measure of economic performance,<sup>69</sup> but we can make a number of tentative conclusions on the basis of the above observations. First, the economics of individual enterprise are a phenomenon of the tertiary sector, particularly commerce. In 1983 1.35 million persons were engaged in individual commerce, which accounted for 50 percent of persons engaged in individual enterprise and 10 percent of *all* persons engaged in commerce in China.<sup>70</sup> At the end of 1984 individual enterprises accounted for almost 73 percent of all retail outlets (*shangye lingshou wangdian*), almost 82 percent of food and beverage outlets, and 47 percent of service outlets.<sup>71</sup> Nationally, individual commerce accounted for 18 percent of all retail sales and this percentage was even higher in some areas.<sup>72</sup> Second, growth of individual enterprise since 1980 has been astonishing. The total number of persons engaged in urban individual enterprise grew over four times from 1980 to 1985.<sup>73</sup> The growth of individual commerce was probably about the same.<sup>74</sup>

Although statistics are scattered, they show that average capital per household invested in individual enterprise and turnover per household more than doubled between 1983 and 1984.<sup>75</sup> Turnover figures probably do not reflect the true situation, however, because turnover may not be fully disclosed by an individual enterprise in order to avoid payment of

66. A major reason given for the decline was lack of supplies of raw materials, *see supra* note 65.

67. It was reported that in Zhoukou City, Henan Province thirteen kinds of fees and levies had proven too onerous for many individual enterprises. They included management fees, fund accumulation fees, rents, electricity fees, sanitation fees, site charges and fees for membership of local associations for the self-employed.

68. *Supra* note 63.

69. This is due to nondisclosure and increasing numbers of unlicensed individual enterprises. It was recently reported that in some busy retail trading places in Beijing between 50 percent and 90 percent of individual traders were unlicensed. *China Daily*, May 26, 1986.

70. 1984 STATISTICAL Y.B. OF CHINA 113, 122; *see* Figure B.

71. 1985 ECONOMIC Y.B. OF CHINA V-257.

72. *China Legal News*, May 9, 1986. In Guizhou, the figure was 19.4 percent. *BUSINESS HANDBOOK*, *supra* note 2, at 5. Both figures are for 1984.

73. *See* Figure A.

74. This is an estimate based on figures for 1984 and 1985 cited *supra* in notes 70 & 71.

75. 1985 ECONOMIC Y.B. OF CHINA V-257. Capital increased from 3.07 billion yuan to 10.01 billion and turnover from 21.16 billion yuan to 45.4 billion. *Id.*

taxes and administrative fees.<sup>76</sup> Finally, results in creating employment have been profound, especially for school leavers and miscellaneous unemployed youth.

#### D. INDIVIDUAL ENTERPRISE DISTINGUISHED FROM CAPITALIST PRIVATE OWNERSHIP

A policy encouraging private enterprise in a socialist country presents obvious potential ideological objections, despite the economic benefits that may accrue to society as a whole. The agricultural production household, although also a form of private enterprise, was easy to defend in ideological terms because it continued to use publicly owned means of production to make a profit that was apportioned between it and the collective, essentially by means of a contract. The individual enterprise, however, uses private capital to turn a profit that is shared with the state only in the sense that taxes must be paid according to law. As a result, ideological defense of the individual enterprise has focused, first, on its economic scale rather than its inherent quality. The promotion of individual economy "is not retrogression to the new democratic economy of the early period of the People's Republic of China when socialist public ownership was not yet *predominant* in town and country."<sup>77</sup> Current ideology emphasizes individual enterprise as a decentralized activity that supplements the socialist planned economy in a necessary and valuable way.<sup>78</sup> Although investment by individuals is tiny in comparison to the public sector, recent developments show that in its ability to absorb the unemployed and to stimulate commerce and service trades the role of the individual enterprise is more than just supplementary.

The second major ideological defense of individual enterprise is its so-called proletarian nature. The social status of private traders was not high even in traditional Chinese society and was dragged down further in socialist campaigns for collectivization. Unlike the "remnants of capitalism," which underwent socialist transformation during the first five-year economic plan, today's individual enterprises do not represent a capitalist class. It has been stressed that some persons engaged in individual enterprise are members of the Chinese Communist Party or the China Youth League; indeed, individual enterprises have recently been encouraged to

76. See *infra* text section V.C.1-5.

77. Decision of the Central Committee of the Chinese Communist Party on Reform of the Economic Structure, Oct. 20, 1984, at 27 (Joint Publishing Co., Hong Kong) (English ed.) (emphasis added).

78. *Id.*



establish their own Party and League organs.<sup>79</sup> Support for the economic and legal status of persons engaged in individual enterprises, however, itself indicates a need to protect them from entrenched negative attitudes. Consequently, legislation provides that individual enterprises must be "respected and their economic role vigorously supported." They must therefore be protected from "discrimination and unwarranted interference" from administrative organs.<sup>80</sup>

### III. Definition of Individual Enterprise

#### A. ECONOMIC MEANING

In China private enterprise is referred to as the "individual economy," that is, production and business activities based on individual labor and private ownership of the means of production. Economically speaking, the so called individual economy is not treated as an independent form of business or production because public ownership of the means of production is the predominant economic form and the individual economy, which constitutes a mere supplement. In 1954 individual industrial enterprise accounted for about 18 percent of total industrial output, but in 1983 this proportion had dropped to only 0.1 percent.<sup>81</sup> Indirect state planning mechanisms also affect the individual economy, as for example in controlling the supply of raw materials and the sales price of products and services.<sup>82</sup> The public economy may predominate but it is hampered by the inability of economic management to respond to worker initiative and to reward increased productivity. The success of the individual economy lies in the way an individual can enjoy directly the rewards of his labor.

#### B. LEGAL MEANING

An individual enterprise acquires its legal capacity to carry on business by registration with the relevant administrative authorities.<sup>83</sup> The National Policy Regulations provide that its property rights are protected by law.<sup>84</sup>

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79. People's Daily, May 9, 1986. It was reported that in Qianan County Jilin Province of 1,500 persons engaged in individual enterprise, twelve were Chinese Communist Party members and 300 were China Youth League members. Here as elsewhere, however, not mentioned is the fact that past criminal offenders may represent a significant portion of "idle persons" absorbed by individual enterprise. See *supra* note 57 and accompanying text.

80. National Policy Regulations, *supra* note 28, preamble; Liaoning Measures, *supra* 33, § 3; Wuhan Regulations, *supra* note 35, § 2.

81. 1954: 9.29 billion yuan or 17.9 percent; 1983: 750 million yuan or 0.1 percent. 1984 STATISTICAL ANNUAL OF CHINA 94.

82. National Policy Regulations, *supra* note 28, § 8, 9.

83. See *infra* text section IV.B.4.

84. *Supra* note 28, § 12.

According to Chinese legal theory, however, property rights are enjoyed only by a "subject of civil law rights."<sup>85</sup> This raises the question whether the individual enterprise enjoys property rights in its own capacity or by virtue of the legal status of its membership.

In order to understand the legal status of an individual enterprise, it is first necessary to understand the meaning of "household" (*hu*). In China the household is the most basic unit of social administration. Usually, the household is based on the family unit and for administrative convenience the household is divided into two parts: the head of the household and other family members.<sup>86</sup>

The concept of household when applied to the individual enterprise, however, is not exactly like the definition given above. This is because the Civil Law defines an individual enterprise as "an individual or family" carrying on a business in common with administrative approval and registration within the scope permitted by law.<sup>87</sup> In practice, the business of a large number of individual enterprises is carried on by only one member of the household, but because administrative practice and the Civil Law confer on them this dual business form it has been argued that the individual enterprise is a discrete subject of civil law rights, different from both legal and natural persons. It is this and contrary opinions that warrant consideration in this section.<sup>88</sup>

The first draft of the Civil Law did not distinguish the individual enterprise or the production household from general provisions on natural persons. It was suggested, however, that because their "character" was not the same as natural persons a separate chapter should be set aside for them.<sup>89</sup> By the second draft a compromise had already been reached whereby they were included in the chapter on natural persons but in their own part. According to advocates of the first view, two fundamental reasons exist for treating individual enterprises differently from natural persons. First, most Chinese are employed in state or collective units, and their wages constitute the family income, so that the family is concerned not with production but with consumption and related family activities. The individual enterprise, however, is an economic entity itself engaged in production or business activities. Second, either the individual or the family can carry on business as an individual enterprise. In either case the same administrative formalities apply to the licensee(s) in the

85. See PRINCIPLES OF CIVIL LAW 31 (Law Press 1985).

86. See Household Registration Regulations in 7 DIGEST OF LEGAL REGULATIONS IN THE PEOPLE'S REPUBLIC OF CHINA 204 (1958).

87. Civil Law § 26.

88. These views are based on our interpretation of as yet unpublished statements made mainly by legal scholars. See also PRINCIPLES OF CIVIL LAW, *supra* note 85, at 155-57.

89. Draft of Aug. 15, 1985.

capacity of an individual enterprise so that only one license is issued per household and special business and income taxes must be paid by the enterprise. Natural persons, according to this analysis, are not subject to such administrative regulation and pay a personal income tax on their wages and salaries.

Alternatively, it may be argued that merely because the individual enterprise is legitimized by an administrative act it does not become a discrete subject of civil law rights. This is obvious when an enterprise is carried on by a single individual, but the argument can also be applied to a family business. Unlike partnership property and an individual partner's personal property, however, the property of an individual enterprise carried on by the family is indistinguishable from the family members' personal property. This is because the individual enterprise is "created" by registration not by an agreement between the parties *inter se*. It would appear, therefore, that without distinguishable property rights the individual enterprise cannot itself become a discrete subject of civil law rights.

The distinction between business property and personal property is clearest with respect to legal persons, but it has never been argued that the individual enterprise should have legal personality independent from its members. The individual enterprise is a small scale undertaking and unlike legal persons there are no limits on its minimum registered capital.<sup>90</sup> By the end of 1984 urban individual enterprises had each invested an average of almost one thousand yuan,<sup>91</sup> far below the minimum registered capital of 50 thousand yuan required of some legal persons.<sup>92</sup> Also unlike a legal person, the individual enterprise's only constitutional document is its license.

The first of the two views just examined looks at the enterprise from economic and administrative perspectives. This view accords the enterprise its own status because of its relations with the state for administrative purposes such as registration and taxation. This might be described as a vertical perspective. The second view, however, looks at the enterprise from a clearly horizontal perspective, that is, from the perspective of civil legal relations which define property rights and obligations between the members of the enterprise themselves and with other persons. This view thus denies the enterprise its own status because it has no property distinguishable from that owned by its members and is unable independently to assume civil liabilities. Both views have their attraction. Uncertainty could be resolved by treating the individual enterprise as a subject of law

90. Provisional Regulations for the Registration of Companies, China Legal News, Aug. 28, 1985.

91. 1985 ECONOMIC Y.B. OF CHINA V-257.

92. See *supra* note 90.

for administrative purposes and as a natural person for the purposes of determining civil liability.

It is necessary to distinguish the rural contract business household (*nongcun chengbao jingyinghu*), which emerged in the course of rural economic reform.

The Civil Law has conferred on them the same legal status as individual enterprises, but there is, in fact, a number of important differences in their status and regulation. First, the system of ownership is different. While an individual enterprise owns the means of production, a rural production household obtains only a contractual right to use the collective's land and farming implements.<sup>93</sup> Second, their business scope and administration are different. Individual enterprises are controlled directly by relevant legislation, whereas the activities of production households are mainly governed by the contract with the collective. Third, conditions of membership are different. Generally, any member of a rural collective is eligible to become a member of a contract business household, but owing to certain policy considerations there are special preconditions on the type of individual who may start an individual enterprise. Moreover, rural production households are usually true household enterprises engaging the whole family; individual enterprises, although based on household registration, are often merely sole traders.

In the final analysis, the legal status of individual enterprise as defined in the Civil Law is not as certain as it may first appear. It is hard to conceive of a business association not based on agreement between the parties. The individual enterprise carried on by a family should be no exception, and the rules of partnership may in fact have the final say in how the status and internal relations of such a business association should be defined. In the meantime, the courts face the difficult job of applying the law to resolve disputes concerning the satisfaction of the individual enterprise's liabilities to third parties.

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93. A similar practice has emerged in the course of urban economic reforms whereby a collective enterprise transfers to an individual the right to conduct business with the collective's property and take a direct profit according to the success or failure of the undertaking. This arrangement is also called "*chengbao*" but at present the status of the individuals contracting such an undertaking is not defined in the Civil Law at all. It would appear they do not constitute individual enterprises if only because they are not issued a business license. As this practice becomes more widespread it will be interesting to see how their legal status is defined. See *A Business Entrepreneur Leases a Restaurant*, People's Daily, Oct. 19, 1985, and *Lease Puts Barber a Cut Above the Rest*, China Daily, Sept. 23, 1986.

#### IV. Preconditions and Procedures for Obtaining a License to Trade as an Individual Enterprise

For the purpose of analysis, the procedures that must be followed to obtain a business license may be divided into two categories. First, there are substantive preconditions which reflect current policy concerning the status of persons who may engage in individual enterprise and the scope of their business activities. Second, the applicant must satisfy procedural conditions relating to the administrative control of individual enterprises before a business license will be issued.

##### A. SUBSTANTIVE PRECONDITIONS

###### 1. *Employment Status*

The policy of promoting individual enterprise as a means of job creation has already been discussed. Only unemployed persons are thus eligible to apply for a business license. Originally the National Policy Regulations and the Licensing Measures restricted applicants to three categories of unemployed persons: "youth awaiting employment" (*daiye gingnian*), "idle persons" (*xiansan ren yuan*), and "retired workers."<sup>94</sup> No special conditions are attached to the first two categories, but retired workers are only eligible if they possess "special skill or business experience and are able to teach apprentices."<sup>95</sup> This condition was modified in the Supplementary Regulations, apparently to promote the participation of more suitably qualified retired workers, by allowing them to receive retirement benefits at the same time as carrying on business. The provision was further extended to retirees who "revive and develop the making of well-known artifacts."<sup>96</sup> Such artifacts probably cover a wide range of handicrafts and products the manufacture of which died out during the "Cultural Revolution." This provision reflects renewed public interest in these products and the desire to promote their manufacture. The Supplementary Regulations also added a new category of unemployed persons: "released convicts and persons discharged from reform through education" institutions.<sup>97</sup>

Most recently in Wuhan the categories of employed persons entitled to apply for a business license were further extended. First, persons belonging to a category designated "surplus rural labor" may also apply

94. National Policy Regulations, *supra* note 28, § 4; Liaoning Measures, *supra* note 33, § 4.

95. *Id.*

96. Supplementary Regulations, *supra* note 34, § 3.

97. *Id.* § 4.

for a license.<sup>98</sup> The word "rural" used here should not be understood in its ordinary sense. The administrative district of Wuhan City includes four townships as well as rural and semirural areas surrounding them. By their inclusion in what is legally speaking an urban administrative district peasants enjoy urban household registration. The inclusion of this new category appears to reflect the growing trend to employ surplus rural labor in the secondary and tertiary sectors.<sup>99</sup> Second, the Wuhan Regulations also provide that "persons remaining in employment without pay" (*tingxin liuzhi*) may apply for a business license.<sup>100</sup> This unusual category of persons is not defined, but essentially it embraces those persons who become voluntarily redundant and lose their pay yet remain with their original work unit to enjoy other benefit such as housing and subsidized medical care.

## 2. Household Registration

It must not be forgotten that the legislation under discussion concerns the status and regulation of nonagricultural individual enterprise in towns and cities. Therefore, the relevant laws all provide that applicants for a business license must have "formal household registration" in their respective "city or township."<sup>101</sup> With the exception of those engaged in *fanyun*, persons with a rural household registration are not eligible to apply.<sup>102</sup>

For urban households the general rule is that a license will be issued for business restricted to the household jurisdiction. The Supplementary Regulations created an important exception, however, by allowing persons, particularly those possessing a skill or business experience, to apply for a business license outside their household jurisdiction while retaining their original household registration.<sup>103</sup> The effect of this provision is to allow qualified persons with urban household registration to apply for a business license in another market township (*jizhen*), including townships that straddle city districts (*chengguanzhen*).<sup>104</sup> This dispensation is liberal

98. Wuhan Regulations, *supra* note 35, § 4.

99. See *supra* notes 59-61 and accompanying text.

100. Wuhan Regulations, *supra* note 35, § 4.

101. National Policy Regulations, *supra* note 28, § 4; Liaoning Measures, *supra* note 33, § 4; Wuhan Regulations, *supra* note 35, § 4.

102. *Fanyun*, or transportation of agricultural products from the countryside to sell in urban areas, is discussed *supra* text immediately following note 37.

103. Supplementary Regulations, *supra* note 28, § 5.

104. A township is established when a rural town's nonagricultural population reaches 10 percent of the total, see Notice Concerning the Adjustment of the Standard for Establishing Townships, Ministry of Civil Administration, Oct. 9, 1984, in ADMINISTRATIVE REGIONS OF THE PEOPLE'S REPUBLIC OF CHINA 148 (1985). At the same time this notice was issued there were already almost 60,000 market townships, not including townships straddling city districts which then numbered 608.

in China where household registration usually determines once and for all the place of an individual's right to reside. The reason behind this exception, apart from the promotion of employment, is the establishment of more small market towns as "collecting and distributing centers for the exchange of materials between town and country."<sup>105</sup>

### 3. *Designated Trades*

The issue of a business license does not allow an individual enterprise the freedom to engage in any trade whatsoever; the license is restricted to certain designated trades, seven of which have already been discussed in detail.<sup>106</sup> As that discussion indicated, individual enterprise is a phenomenon of the tertiary sector, focusing on labor services and responding largely to market forces. As needs have increased and changed, therefore, the range of business activities has expanded. So too the legislation concerning individual enterprise reflects the continuous expansion of business scope.

Expansion is most obvious in the designated service trades that first included mainly utilitarian services such as hairdressing and laundry, but have since developed to cater to a wide variety of leisure pursuits such as billiards and book rental.<sup>107</sup> The scale of business has grown too. The recent establishment of a private manual telephone exchange in Beijing has already been mentioned.<sup>108</sup> Further, China's new Mining Resources Law specifically provides for the encouragement of individual enterprises to quarry for building materials such as sand and stone, as well as for small quantities of other resources for their own use.<sup>109</sup>

## B. PROCEDURAL CONDITIONS

Individuals who satisfy the three substantive preconditions are eligible to apply for a business license, but before a license will be issued the applicant must comply with several further procedures.

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105. Notice Concerning the Question of Peasants Taking Up Residence in Market Townships, State Council, Oct. 13, 1984, in *ADMINISTRATIVE REGIONS OF THE PEOPLE'S REPUBLIC OF CHINA* 145 (1985). This notice represents a complementary policy to facilitate the migration of peasants to market townships, not including townships which straddle city districts, to absorb surplus rural labor and promote the development of decentralized economic exchange between towns and cities. It should be considered along with other recent legislation facilitating but nevertheless controlling economic migration, for example, *Provisional Regulations for the Administration of Temporary Residence in Towns and Cities*, Ministry of Public Security, July 13, 1985, *People's Daily*, Sept. 8, 1985, at 5.

106. See *supra* text section II.A.

107. Wuhan Regulations, *supra* note 35, § 7.

108. See *supra* text II.A.4.

109. Mining Resources Laws § 37, adopted on Mar. 19, 1986, *People's Daily*, Mar. 20, 1986.

### 1. *Approval of the Residents' Committee*

China's urban society is partially self-regulated by the residents' committees and subcommittees that serve local residents who can be counted in hundreds of households as opposed to the thousands of households administered by the last tentacle of government, the street affairs office. Although not themselves an organ of government, the residents' committees are a means of social administration responsible for general social welfare and order as well as a link between residents and their representatives in government.<sup>110</sup> They have from time to time also exerted some economic influence, but it is more likely to be in deference to their local administrative functions that legislation on individual enterprise has conferred on them the right to "endorse with comments" a resident's application for a business license.<sup>111</sup> Such an endorsement, however, appears to be merely a formality to show that the applicant belongs to one of the categories of unemployed persons and is thus eligible to apply in the first place. The residents' committee would therefore be unlikely to raise any objections to the application; even if it did, the action would not appear to fetter the licensing authority's overall power to issue a license. The residents' committee is more likely to support actively an individual enterprise that brings a special benefit to the local community, as in the above case of the private telephone exchange, where equipment was purchased by the licensee with the financial assistance of the residents' committee.

### 2. *Production and Business Facilities*

The applicant must satisfy the licensing authorities that he or she possesses or can obtain the necessary premises and equipment to carry on business. Apart from itinerant hawkers, transport enterprises, and the like, an individual enterprise must have a fixed place of business, be it a workshop or merely a stall in the marketplace. The individual enterprise may borrow, lease, or purchase premises on the open market,<sup>112</sup> but most commonly, especially in commerce, the licensing authorities allocate a stall, table, or place on the street or in the marketplace and include its value in a monthly administration fee. Shortages of space are a constant headache in China, so that despite a statutory duty on local government to make overall provision of business premises for individual enterprises,

110. For an old, but still valuable, discussion of residents' committees and their relation to the state apparatus see Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China* 55 CALIF. L. REV. 1284 (1967).

111. National Policy Regulations, *supra* note 28, § 4; see also Wuhan Regulations, *supra* note 35, § 5.

112. National Policy Regulations, *supra* note 28, § 6.



the lack of business space has discouraged many would-be individual commercial enterprises.<sup>113</sup> Business equipment may range from a simple set of scales to a handmade cooked food trolley to a small manual telephone exchange. The legislation provides that business equipment may also be borrowed, leased, or purchased, but outright purchases are most common.<sup>114</sup>

### 3. *Special Trades and Occupations*

Further approvals must be obtained where the applicant wishes to engage in a specially regulated trade or occupation. Special regulation occurs in two basic forms. First, special legislation may regulate a particular activity independently of or in addition to the general provisions concerning individual enterprise. Medical practice, for example, is so obviously beyond the administrative scope of normal licensing authorities that quite separate criteria and administrative procedures are provided in separate legislation.<sup>115</sup> In other cases, such as nonmotorized tricycle transport in Beijing, special criteria, such as the applicant's age and state of health, and special procedures, such as registering with the traffic safety authorities, must be satisfied in addition to ordinary legislation concerning individual enterprise.<sup>116</sup> A detailed discussion of these laws is beyond the scope of this article but the policy considerations in allowing and regulating these activities are substantially the same as for individual enterprise as a whole.

Second, existing legislation sometimes includes special procedures concerning individual enterprise to ensure compliance with the general regulation of a particular activity. For example, applicants proposing to serve or sell food and beverages must pass a medical examination given by the health authorities to prevent the spread of epidemic disease.<sup>117</sup> Similarly, applicants must first register with the appropriate local authorities before

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113. See *supra* text accompanying note 62. Both the National Regulations, *supra* note 28, § 6, and the Supplementary Regulations, *supra* note 34, § 8, provide that special arrangements should be made to accommodate the needs of individual enterprises for business space. The Wuhan Regulations, *supra* note 35, § 12-15, devote one part to the creation of business places and their compliance with the city's general regulations on urban planning.

114. Cf. *infra* text session V.A.1.

115. See, e.g., Provisional Measures for Individual Medical Practice in Jiangsu Province, Mar. 16, 1983, in *SELECTION OF LAWS AND REGULATIONS ON NON-AGRICULTURAL INDIVIDUAL ECONOMY* 164 (Workers' Press 1982).

116. See, e.g., Provisional Measures for Non-Motorized Tricycle Passenger Transport in Beijing City, Apr. 1, 1983, *Beijing Daily*, Mar. 22, 1983.

117. Liaoning Measures, *supra* note 33, § 15; Wuhan Regulations, *supra* note 35a, § 5. This ensures initial compliance with general public health legislation with which the individual enterprise must continue to comply in the course of business: Foodstuffs Hygiene Law, Nov. 19, 1982, *DIGEST OF LAWS OF THE PEOPLE'S REPUBLIC OF CHINA* 356 (1979-1984).

engaging in a number of special activities. For example, to prevent crime, individual enterprises managing hostels, cutting keys, and carving seals must register with the public security organs. Book or magazine sale or rental and billiard table rental trades must register with local cultural or education authorities. Individual enterprises engaged in certain other activities, such as selling popsicles or tea to drink, must also register with their local street affairs office.<sup>118</sup> Once registered, the respective authorities are supposed to maintain constant supervision over the individual enterprise's activities.<sup>119</sup>

#### 4. Overall Approval by the Licensing Authority

The designated licensing authority for individual enterprises, except medical practice, is the State Administration for Industry and Commerce (SAIC). It is a vast national administrative organization whose supervisory functions over public industry and commerce have now been applied to the private sector.<sup>120</sup> The SAIC at city and county levels has the power to issue a business license and, therefore, it also has overall responsibility for approving an application.<sup>121</sup> The business license is the only lawful evidence of the right to carry on business and the individual enterprise's only "constitutional" document. It is issued in duplicate, the original bearing the seal of the SAIC and carrying the holder's photograph, name, business name if any, and the permitted scope of business. The original must be displayed in a prominent position at the place of business; the duplicate may be used as proof in daily business activities, such as when ordering from wholesale suppliers, opening a bank account, and registering with the taxation authorities.<sup>122</sup>

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118. All these examples have been taken from the Wuhan Regulations, *supra* note 35, § 5, 7.

119. In fact, the State Administration for Industry and Commerce which has the overall supervisory responsibility for individual enterprise is severely hampered by a lack of personnel. In an article decrying violent clashes between SAIC personnel and peddlers in Tianjin it was revealed that there were only about 160,000 SAIC personnel responsible for about 17 million persons engaged in individual enterprise in about 62,000 retail and wholesale markets throughout China. *People's Daily*, Aug. 26, 1986 (overseas ed.).

120. For a general discussion of the rule of the SAIC, see Lutz, *The General Administration for the Control of Industry and Commerce*, *CHINA BUS. REV.* Mar.-Apr. 1983, at 25. The role of the SAIC in licensing collective enterprises has also been examined recently, see Chao & Yang, *Private Enterprise in China: The Developing Law of Collective Enterprises*, 19 *INT'L LAW.* 1215 (1985).

121. SAIC Regulations Concerning Certain Questions About the Registration of Co-operative Business Associations and Individual Enterprises in Towns and Cities (1983) in *COLLECTION OF LAWS AND POLICIES ON COMMERCE* 1004 (Economic Science Press 1984).

122. SAIC Regulations Concerning Individual Enterprises National Unified Business Licenses and Their Relevant Particulars, Sept. 5, 1983, [hereinafter SAIC Regulations Concerning Individual Enterprises] in *COLLECTION OF LAWS AND POLICIES ON COMMERCE* (Economic Science Press 1984).

Once a business license has been issued the SAIC retains a supervisory role over individual enterprises to ensure compliance with the terms of the license and laws generally within the jurisdiction of the SAIC.<sup>123</sup> All business licenses must be submitted for inspection once a year.<sup>124</sup> When an individual enterprise ceases business, or wishes to change its business scope or any other particulars of its original registration, it must first notify the SAIC and complete further procedures.<sup>125</sup>

## V. Regulation of Business Activities

No complete set of laws regulates the business activities of individual enterprises, but a wide number of regulations and policies regulate internal management requirements of individual enterprises as well as their relationships with third parties.

### A. CONTRACTS

The contract is the individual enterprise's most important means of economic exchange with third parties. The Law of Economic Contracts paragraph 54 provides that "contracts made by individual enterprises or agricultural workers in collectives shall be carried out with reference to this Law." Of ten types of contracts specified by the law, eight are relevant to the individual enterprise: contracts for the sale of goods, for work and materials, for the transport of goods, for the supply of electricity, for the storage of goods, for the lease and insurance of property, and for borrowing money.<sup>126</sup>

Generally speaking, the contract will be valid only if it is within the scope of business specified in the business license. As the ultimate object of individual economics is to supplement those areas neglected by China's massive public economics, the subject matter of a contract is usually quite

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123. Supplementary Regulations, *supra* note 34, § 14. The breadth of the SAIC's supervisory jurisdiction is illustrated by a recently reported case of illegal trading in foreign exchange certificates (a special Chinese currency used in the place of convertible currencies) by a clothing vendor. SAIC officers who apprehended the offender at a designated market fined him and confiscated the foreign exchange certificates. China Daily, May 13, 1986. The question of administrative sanctions and the rights and obligations of individual enterprises and the SAIC *inter se* is discussed below. See *infra* text section VI.B.

124. SAIC Regulations Concerning Individual Enterprises, *supra* note 122, § 6.

125. National Policy Regulations, *supra* note 28, § 4; Liaoning Measures, *supra* note 33, § 14; Wuhan Regulations, *supra* note 35, § 9.

126. Law of Economic Contracts, National People's Congress, Feb. 23, 1981. Economic contracts are contracts that were once almost always made between legal persons to realize an economic objective usually related to production within the centrally planned economy. They are often distinguished from civil contracts, which are said to be restricted to natural persons, but in the course of current economic reforms the distinction has become blurred.

small. Wholesale of goods, the supply of electricity and metals, and building and construction, are usually beyond the scope of an individual enterprise.

Despite recent trends to deregulate prices, the sales and service activities of an individual enterprise are still generally subject to administrative price control. The Provisional Price Administration Regulations of 1982 provide that "where individual enterprises purchase goods at wholesale prices from state or collective enterprises they must be sold in accordance with the retail price fixed by the state."<sup>127</sup> Similarly, where goods are made with raw materials supplied by state distribution departments they must be priced with reference to similar goods produced by state enterprises. Where raw materials have been purchased at market prices, however, products may also be sold at market prices. Similar provisions apply to services, although in this area the parties more frequently decide the "right price," particularly in transport services.

Contracts are usually settled for cash and the difficulties this creates for the collection of taxes will be discussed below.

## B. INTERNAL BUSINESS MANAGEMENT

Unlike state and, to a lesser extent, collective enterprises, the individual enterprise is largely unaffected by state planning intervention in its business and production activities. State and collective enterprises are subject to direct planning intervention (*diaobo*), which regulates what goods are produced in what quantity and to whom they are sold at what price. The individual enterprise, however, will generally only have to observe indirect planning control in the form of the unified distribution of raw materials and price control mentioned above. There are three major aspects to internal management.

### 1. *Capital*

An individual enterprise with small capital requirements will usually be satisfied by personal investment by its member(s). When greater initial capital or further investment is required, however, local government or "masses" organizations may assist the individual enterprise with loans or even grants.<sup>128</sup> Alternatively, a bank loan may be requested<sup>129</sup> and granted on the basis of the business license, having regard to the individual

127. Provisional Price Administration Regulations, State Council, July 7, 1982, ¶ 9.

128. See *supra* text section IV.B.1.

129. National Policy Regulations, *supra* note 28, § 10.

enterprise's business activities and ability to repay the loan.<sup>130</sup> The annual interest rate is 4.2 percent.<sup>131</sup>

## 2. *Labor Management*

The National Policy Regulations provide that an individual enterprise may employ a maximum of two workers and in certain trades may take on up to five apprentices.<sup>132</sup> In practice, however, these limits are often exceeded. When workers or apprentices are employed a contract must be made to define their rights and liabilities, including wages and conditions. The SAIC must examine and approve the contract.

## 3. *Insurance*

Insurance law is still a relatively undeveloped area of law in China. The National Policy Regulations provide, however, that in principle an individual enterprise can participate in old age and health insurance as do workers in state and collective units.<sup>133</sup> In addition regulations provide for the compulsory insurance of third-party risks in transport trades.<sup>134</sup>

## C. ACCOUNTS AND TAXATION

Despite any ambiguity in its civil legal status, the individual enterprise is liable to a wide range of taxes. It pays income tax as a distinct taxable entity<sup>135</sup> and a variety of other taxes by virtue of its members' status as natural persons. With twenty-two business and income taxes alone, China's system of taxation is complex and in a constant state of flux as it is reformed in tandem with the economic system. This article examines only the three taxes relevant to the individual enterprise: business tax, products tax, and income tax.

Recent reforms in the taxation of industrial and commercial activities in China make it impossible to understand today's taxation system without

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130. Bank loans appear readily available, however, as is illustrated by a recent case where a person fraudulently obtained four business licenses and opened four bank accounts in a variety of business names to obtain four different loans from the Industrial and Commercial Bank. *People's Daily*, May 24, 1986.

131. Notice of the Chinese People's Bank Concerning the Expansion of Interest Bearing Deposits and Individual Loan Interest Rates, in *SELECTION OF LAWS AND REGULATIONS ON NON-AGRICULTURAL INDIVIDUAL ECONOMY* 17 (Workers' Press 1982).

132. National Policy Regulations, *supra* note 28, § 5.

133. *Id.* § 13.

134. Certain Regulations Concerning Peasants or Co-operative Households Setting up Transport Trades with Motorized Vehicles Boats and Tractors, State Council, Feb. 27, 1984, in *SELECTED DOMESTIC ECONOMIC REGULATIONS* 267 (Shanghai 1985), provide for the insurance of third party risks, shipping collision risks and passenger injury risks.

135. Provisional Income Tax Regulations for Individual Enterprises in Urban and Rural Areas, State Council, Jan. 7, 1986, in *China Legal News*, Jan. 29, 1986.

knowing a little of what came before and why it was changed. In 1958 the Industrial and Commercial Consolidated Tax Regulations (ICCT) had already established the pattern of taxation of industry and commerce that remained basically unchanged until major tax reforms began early this decade.<sup>136</sup> The ICCT is essentially a turnover tax levied on the production and wholesale of over one hundred products and on the gross receipts of retail, transport, and service trades. It was not an income tax. Such a tax had been included in the first industrial and commercial tax regulations,<sup>137</sup> but income tax was not important in a system where all state-owned corporations turned over a large portion of their profits to the state. Both the ICCT and remnants of early income tax legislation were applicable to individual enterprises until the introduction of recent reforms, although income tax rates and assessment methods were not unified.<sup>138</sup>

The goal of current taxation reforms has been to replace the ICCT<sup>139</sup> with three new business, products, and value-added taxes that are better able to act as macro-economic regulators, and to enact three new income tax laws, one each for state-owned corporations, collective corporations, and individual enterprises. The purpose of these laws is to create independence in the reinvestment of profits and autonomy in business management generally.

### 1. *Business Tax*<sup>140</sup>

Business tax is a turnover tax levied on eleven categories of business activity at rates that vary from 3 percent to 15 percent. Business categories

136. The ICCT was "reformed" by another set of Industrial and Commercial Regulations in 1972 which merged tax categories, simplified tax rates and decentralized tax collection. "It was clearly influenced by leftist thinking . . . resulting in an industrial and commercial tax which was a blurred conglomerate of many taxes." LIU LONGHENG, *INTRODUCTION TO CHINA'S LAW OF TAXATION* 14 (Beijing University Press 1986). The 1972 Regulations were apparently never implemented and now have fallen into complete disuse.

137. Provisional Regulations on Industrial and Commercial Tax, Jan. 27, 1950, in 1 *DIGEST OF LAWS AND DECREES OF THE CHINESE CENTRAL PEOPLE'S GOVERNMENT* 298 (1949-1950).

138. In October 1980 the Ministry of Finance issued a Notice Concerning the Improvement of Co-operative Retail Shops and Individual Enterprises Paying Industrial and Commercial Income Tax which was supposed to reduce significantly their tax burden by relocating them on an eight-point marginal rate tax scale, ranging from 7 percent to 55 percent of annual income. 2 *SELECTION OF ADMINISTRATIVE REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA* 110 (North West Institute of Politics and Law 1949-1984). In fact, income tax rates levied on individual enterprise varied from region to region. For example, the scale in Jiangsu Province ranged from 5 percent to 50 percent but in Liaoning province tax rates ranged from 7 percent to 80 percent. *SELECTION OF LAWS AND REGULATIONS ON NON-AGRICULTURAL INDIVIDUAL ECONOMY* 194, 202 (Workers' Press 1982).

139. The ICCT is still in force, but applicable only to certain commercial activities in the course of foreign investment.

140. Business Tax (Draft) Regulations, Oct. 1, 1984; *see also* Business Tax (Draft) Regulations Implementing Provisions, Sept. 28, 1984, [hereinafter Implementing Provisions], in *PRACTICAL TAXATION HANDBOOK* 140, 144 (Workers' Press 1985).

include wholesale and retail sales and fifty-two types of service trades broad enough to include any business activity already discussed, except quarrying. The tax is levied on gross receipts except those from wholesaling, where only the difference between the cost of the goods and their wholesale price is taxed. An increasingly common practice of individual enterprises is to wholesale goods or to sell wholesale quantities at retail prices. This practice has obviously created such difficulties for tax collectors that the Ministry of Finance has ruled that unless wholesale and retail sales are kept separate (presumably in accounts), they will all be levied at the much higher retail tax rate.<sup>141</sup> Business receipts are taxable only when they have reached a designated threshold. The national regulations provide a wide range of possible thresholds, but the provincial authorities must choose the appropriate threshold in the light of local conditions.<sup>142</sup> Normally business tax is levied on cash receipts. To deal with the problem of tax evasion, however, national regulations provide for the payment of business tax *before* the retail sale of goods; that is, the business tax on retail sales is deducted by the wholesaler at the time he sells the goods to the retailer.<sup>143</sup>

## 2. *Products Tax*<sup>144</sup>

Products tax is a transaction tax levied on 270 types of primary and manufactured products. When primary produce is sold by the producer to a state or collective wholesaler, the wholesaler must pay the tax. (It is not clear, however, who is liable for the tax when the sale is to an individual enterprise acting as a retailer *or* wholesaler.) When produce is sold directly to the consumer, as in the case of *fanyun*, the producer-seller must pay the tax. In cases of the sale of manufactured goods, generally the manufacturer is responsible for the tax on the basis of the product's sales receipts. When the goods are manufactured on behalf of a third party, the tax is usually deducted by the manufacturer before

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141. Regulations on Certain Specific Questions about Business Tax, in PRACTICAL TAXATION HANDBOOK 150 (Workers' Press 1985).

142. Implementing Provisions, *supra* note 140, § 6.

143. In this way the wholesaler acts as the tax collector's agent. If the retail price is fixed it is not difficult to assess the tax. If not fixed, the retail price is estimated at between 10 percent and 20 percent above the wholesale price. Of course, if the real price is higher still adjustments will have to be made on the basis of actual receipts. See Notice Concerning the Deduction of Retail Industrial and Commercial Tax on Individual Hawkers and Some Collective Corporations by Wholesale Departments, Ministry of Finance, Aug. 17, 1983, in ECONOMIC JUDICIAL WORKER'S HANDBOOK 113 (Yunnan Province 1984).

144. Products Tax (Draft) Regulations, Oct. 1, 1984; see also Products Tax (Draft) Regulations Implementing Provisions, Sept. 28, 1984, in PRACTICAL TAXATION HANDBOOK 32, 33 (Workers' Press 1985).

when the goods are finally sold. Products tax must also be paid on imported goods, in which case the customs administration acts as the collecting agent. Tax rates vary from a high of 60 percent for cigarettes to a low of 3 percent for the matches with which to light them.

### 3. *Income Tax*<sup>145</sup>

China's first personal income tax was enacted in 1980.<sup>146</sup> Individuals were not, of course, previously free from tax liability. As this article has already discussed, however, liability was, and still is, based on the nature of the activity generating their income. As a result, personal income derived from production, business, and commercial activities is not liable to personal income tax, but is still taxed separately according to its source. Personal income tax is thus confined to income, mainly of foreign residents in China, arising from employment and earnings from interest, rent, royalties, and so on.

The Individual Enterprise Income Tax (IEIT) is in fact a business income tax not a personal income tax.<sup>147</sup> Unlike methods for the aggregate assessment of partnership income in some western countries, the IEIT taxes an individual enterprise as a distinct taxable entity without regard to its internal composition. Therefore, if two or more members of one family trade as an individual enterprise, their tax liability is presumably joint and several.

IEIT tax rates are divided into ten marginal rates ranging from seven percent for 1,000 yuan per annum to 60 percent when annual income exceeds 30 thousand yuan. Unlike business tax, IEIT has no threshold. When annual income exceeds 50 thousand yuan a supertax is imposed at a rate of between 10 percent and 40 percent as designated by the regional government. These rates are much higher than for personal income tax, but they compare favorably with earlier provincial rates of industrial and commercial income tax. For example, assuming that an individual enterprise has an annual taxable income of 2,400 yuan (U.S. \$750), it will now be liable for an average of 13 percent income tax. Before the IEIT was introduced, however, this enterprise, in at least four provinces, would have paid more than 15 percent income tax.<sup>148</sup> By way of comparison, a collective corporation would be liable to only an average of 11 percent,<sup>149</sup>

145. See *supra* note 135 and accompanying text.

146. Individual Income Tax Law, Sept. 10, 1980, in PRACTICAL TAXATION HANDBOOK 195 (Workers' Press 1985).

147. Wages are not subject to the IEIT. IEIT § 2.

148. The provinces were Jiangsu, Sichuan, Shandong, and Guizhou, SELECTION OF LAWS AND REGULATIONS ON NON-AGRICULTURAL INDIVIDUAL ECONOMY 202 (Workers' Press 1982).

149. Collective Corporate Income Tax, in PRACTICAL TAXATION HANDBOOK 255 (Workers' Press 1985).



collective corporation would be liable to only an average of 11 percent,<sup>149</sup> and if this income were salary or wages it would be exempt from personal taxation altogether as it is still far from the taxable threshold.<sup>150</sup>

The National Policy Regulations provided that when an individual enterprise's business activity was urgently or widely needed but generated little profit its liability to tax could be reduced or exempted.<sup>151</sup> The IEIT provides that single old-aged persons, the physically handicapped, and members of a revolutionary martyr's family, as well as business activities with an urgent social need, which are labor intensive but with income below a set standard are eligible for preferential tax treatment.<sup>152</sup> This provision and the lack of a taxable threshold both reflect a social need to treat favorably special cases without exempting the generally prosperous individual enterprise from full taxation.

#### 4. *Accounting*

Taxation assumes a system of accounts upon which earnings may be assessed and a rigorous system of tax collection. In both respects, however, the taxation of individual enterprises is problematic. First, there are only about 360,000 taxation workers responsible for tax assessment *and* collection from state, collective, and individual enterprises throughout China. In an area of Beijing surveyed, six taxation workers were responsible for over one thousand individual enterprises. Second, while state and collective business transactions are almost always conducted by means of bank transfers, individual enterprises usually conduct business on a cash basis. Tax assessment therefore relies almost totally on the integrity of an individual enterprise's bookkeeping. Until recently, however, only partnerships and individual enterprises employing workers engaged in production activities were obliged to keep accounts at all.<sup>153</sup>

The IEIT now provides that all individual enterprises must keep an accounts book available for inspection to the taxation authorities.<sup>154</sup> Tax collection was recently strengthened by a new law that systematizes law and practice, but adds little to the tax administration of individual enterprises. It reaffirms an earlier regulation that individual enterprises must

149. Collective Corporate Income Tax, in PRACTICAL TAXATION HANDBOOK 255 (Workers' Press 1985).

150. Individual Income Tax Law, *supra* note 146. Since this is a tax on monthly income, we are assuming it would be spread evenly over the twelve calendar months.

151. National Policy Regulations, *supra* note 28, § 11.

152. *Id.* § 5.

153. Notice Concerning the Liability of Individual Enterprises to Pay Tax According to Law, Ministry of Finance and General Taxation Administration, Oct. 8, 1983, § 3, 2 SELECTION OF ADMINISTRATIVE REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA 335 (1949-1984) (North West Institute of Politics and Law).

154. IEIT § § 10, 11.

register with the taxation authorities within thirty days of commencing business and must carry their tax registration documents at all times.<sup>155</sup> Further, it provides administrative penalties for tax evasion, inadvertent nonpayment, or late payment of tax. In serious cases, criminal penalties may be imposed as specified in the Criminal Code.<sup>156</sup>

### 5. Other Administrative Fees and Expenses

Apart from liability to pay tax, individual enterprises are also subject to a number of administrative fees related to their business activity. For example, a business license is issued for only a small administrative fee.<sup>157</sup> When an individual enterprise is allocated a business place in a designated market or similar commercial center an administration fee of between one and two percent of turnover is collected each month by the SAIC.<sup>158</sup> The individual enterprise is not liable to pay any other fees or expenses beyond the scope or rates of those set by either national or regional government and collected by the SAIC.<sup>159</sup>

It has not become common practice, however, for the scope and rates of such fees to be publicly circulated. If published at all they are usually to be found only in digests of legislation rarely consulted by the layperson. The individual enterprise is therefore prey to unreasonable and unlawful demands for excessively high fees by corrupt officials or to trumped up fees by any person in a position of authority. In principle legal remedies exist, but general public ignorance of these still developing legal procedures is a serious practical obstacle to legal redress in such situations.<sup>160</sup>

155. Provisional Regulations for the Administration of Tax Collection, July 21, 1986, § 6, 34, China Legal News, May 7, 1986.

156. IEIT § 37, 39.

157. Regulations provide that fees relating to license must not exceed a reasonable charge for administrative expense. See *supra* note 122.

158. Measures for Administration of Market Trade in Rural and Urban Areas, State Council, Feb. 5, 1983, COLLECTION OF LAWS AND POLICIES ON COMMERCE 220 (Economic Science Press 1984).

159. National Policy Regulations, *supra* note 28, § 12; Liaoning Measures, *supra* note 33, § 12; Wuhan Regulations, *supra* note 35, § 23.

160. The Supplementary Regulations, *supra* note 33, § 13, provide that where an individual enterprise's rights are infringed it may make a public complaint (*konggao*) to local or superior level government or bring a court action according to law. Current law, however, would restrict means of redress for extortion of fees to an administrative complaint or in serious cases a complaint to prosecutorial organs. See *infra* text immediately following note 177. The most effective means of redress is probably to enlist the assistance of a journalist from one of the major daily newspapers to expose such malpractices. Such cases were regularly reported early in 1985 as is illustrated by two items in the *Economic Daily* exposing the extortion of large "fines" from individual enterprises in transport trades on the basis of petty traffic violations, *Economic Daily*, Jan. 29, 1985, and excessive "taxes," *Economic Daily*, Jan. 23, 1985, both extorted by abuse of authority.

## VI. Legal Liability and Dispute Settlement

### A. LIABILITY

As this article has already pointed out, the legal status of an individual enterprise is uncertain. The business license gives all eligible members of the licensee's household the right to carry on business in common. Therefore, the individual enterprise may be carried on by the licensee alone, in effect as a sole trader, or by part or all of the licensee's household. This raises difficult questions about apportioning legal liability.

In our earlier discussion of the legal status of an individual enterprise we saw that it is not necessary for members to agree as to the contribution of capital and distribution of profits. Therefore, the individual enterprise's property, unlike a partnership, is effectively indistinguishable from its members' personal property. It may be unfair, however, to attach property that represents the wages of a household member not engaged in the business activities of the individual enterprise. It is for this reason that the Civil Law distinguishes between individual and family property as sources for satisfying business liabilities on the basis of who participates in the business. When the business is carried on by one person, business liabilities are borne by that person's property only, but when the business is carried on by the "family," liabilities are borne by the "family property."<sup>161</sup> Who bears the liabilities of an individual enterprise thus depends not on its registration but on who actually participates in the business.

"Family property" means the property that is jointly owned in indivisible shares by those members of the family living together who have made a material contribution to bring that property into existence or add to it.<sup>162</sup> It is an aspect of joint ownership that has its historical roots in the common property of the traditional Chinese family.<sup>163</sup> Although the owners of socialist family property enjoy equal rights over it to satisfy their daily needs, they also incur joint and several liability for external civil obligations that arise in connection with the family property.<sup>164</sup> Therefore, where the Civil Law provides that debts are borne by the family property, the result will be that every family member bears joint and several liability for the debts of the individual enterprise.<sup>165</sup> The apportionment of civil liability on the basis of individual or family participation in the business creates a serious problem when the business is

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161. Civil Law § 29.

162. Yang Zhenshan, *A Discussion of Our Country's Joint Right of Ownership of Family Property* in *COLLECTION OF ESSAYS ON CIVIL LAW* 210-11 (Shanxi People's Press 1985).

163. See D. KULP, *COUNTRY LIFE IN SOUTH CHINA* (New York 1925).

164. Yang Zhenshan, *supra* note 162, at 215.

165. *LECTURES ON THE GENERAL PRINCIPLES OF CIVIL LAW* 63 (Chinese University of Politics and Law Press 1986).

carried on by less than the entire household. The Civil Law does not provide for this situation, but application of the rule that "family" participation gives rise to "family" liability could result in liability of a family member who has not participated in the business at all. One simple and therefore attractive method of curing this inequity could be to find a partnership between those family members carrying on the business in common. Their liability could then be apportioned according to their capital contribution or other agreement.<sup>166</sup> The difficulty with such an analysis, however, is that the partnership agreement would almost certainly not be in writing, as is required by the Civil Law, and would therefore be void for informality.<sup>167</sup> The strictness of the Civil Law's requirement that the partnership agreement be in writing probably arises from a concern that an unchecked proliferation of partnerships could open the door to private pseudo-companies. This requirement will be difficult to enforce in China because of a traditional lack of concern for legal form. It remains to be seen, however, whether in judicial practice this requirement will be treated as substantive or merely procedural, and if the latter, whether the courts can mitigate its strictness by implying a partnership where there has been such conduct as to show the parties' true intention.

A second view, then, could turn on a presumption that by taking part in business activities the household member must accept liability for obligations arising from the course of business. This analysis turns on the use of property rather than an implied partnership agreement. But one question still remains: What constitutes participation in the business? A family member with a full-time job is not strictly entitled to engage in individual enterprise.<sup>168</sup> so even if he did participate in the business part-time, should he be liable for business debts at all? On the other hand, should a wage-earning family member be able to enjoy business profits but remain immune from its losses?

Yet another approach could be to view some family members as mere employees of an individual enterprise carried on by another member of the household. This view would depend on whether a "family employee" really had a say in how the business was run rather than on the question of capital contribution as is the case when defining a partnership. This also raises questions about remuneration of family members and their status vis-à-vis their family "employer."

Clearly, by distinguishing liability on the basis of participation in business activities rather than on capital contribution and profit-sharing the

166. Civil Law ¶ 35.

167. *Id.* § 31 provides that a partnership agreement must be in writing.

168. This view is based on the spirit behind the registration conditions, that is, to create employment. See *supra* section IV.A.1.

Civil Law has made it very difficult to apportion liability. The attachment of family property to satisfy business debts was also a vexing problem before 1949. This is perhaps the inevitable consequence of a social organism taking on an economic function.

## B. DISPUTE SETTLEMENT

Whatever the difficulties in defining its substantive legal status, it is clear that an individual enterprise can sue and be sued as a subject of procedural law. Because many individual enterprises are effectively sole proprietorships, it is usual for actions involving them to be brought or defended in the name of the licensee.<sup>169</sup> If the effect of the Civil Law is now that household members may also be liable for business debts, however, it seems more appropriate to sue in the enterprise's trade name. This would ensure that the court could ascertain and join in the action all members of the household participating in the business.<sup>170</sup>

Disputes that may concern an individual enterprise fall into three general categories: contract, tort, and "administrative appeals." The range of dispute settlement procedures available is standard: mediation, arbitration, and litigation. The individual enterprise does, however, enjoy a certain flexibility in its dispute settlement options not usually available to both natural and legal persons. For example, the individual enterprise, unlike natural persons, has the capacity to make "economic contracts" with legal persons.<sup>171</sup> Unlike disputes over "civil contracts," such as between natural persons only, economic contract disputes may be resolved by an arbitral committee of the SAIC.<sup>172</sup> Economic contract disputes may also be taken directly to the People's Court.<sup>173</sup>

A plethora of administrative regulations affect the individual enterprise in its various activities. The right to appeal against an administrative decision, however, is unusual in China. No special forum or procedure exists for administrative appeals. When a law does provide for an appeal it is usually for review by a superior level of the decision making authority and then for judicial review by the People's Court. For example, when

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169. See, e.g., the case of Pan Yigen who in 1982 brought an action in the Nanjing Intermediate People's Court to enforce a contract for the supply of small hot presses manufactured by him, his wife, and child. The members of his family did not appear as parties to the action. This situation also obtains in respect of rural contract business households where production contracts are usually made with only one household member. *SELECTION OF CASES ON ECONOMIC DISPUTES* 45 (1984).

170. Code of Civil Procedure § 47.

171. See *supra* note 126.

172. Regulations on Arbitration of Economic Contracts, State Council, Aug. 22, 1983, § 8.

173. Economic Contracts Law § 48.

an individual enterprise is aggrieved by a taxation assessment it may appeal first for administrative review by the taxation authority at a superior level, and then, if still dissatisfied, to the People's Court.<sup>174</sup> Only tax laws enacted since 1980 include this right, however. By way of contrast, tax laws promulgated in the 1950s allow the aggrieved taxpayer only a right of appeal to superior levels of the tax administration.<sup>175</sup> There are similar rights to appeal against administrative action taken to enforce the Food Hygiene Law.<sup>176</sup>

Rights of appeal against other administrative decisions are unclear; for example, when an individual enterprise is aggrieved by a decision of its licensing authority, the SAIC. The SAIC may refuse a license or may suspend or revoke a license, but the regulations provide no mechanism to appeal such a decision.<sup>177</sup> If the aggrieved party believes the SAIC's decision is wrongful, that party may make an administrative complaint to the local people's government, or in serious cases, exercise the constitutional right to commence a criminal investigation by making a complaint to a judicial organ.

The Civil Law has created a new right to claim redress against an administrative authority when it has harmed a person's lawful interests.<sup>178</sup> Although the language used in this provision is very broad, from its position in the code it is clearly designed to expose administrative authorities to tortious liability arising from their employees' performance of public duties. This provision is especially remarkable in China because, when a tort is committed, it strips the administrative authority of any superiority in respect of its administrative subject and makes it liable for a tort as if it were an ordinary and equal legal subject. The provision has obvious application when the SAIC or a similar authority wrongfully interferes with an individual enterprise's business activities, thereby causing economic loss. It will be interesting to see if and how this provision is enforced by the courts.

## VII. Conclusion

Encouragement of individual enterprises in China today bears many similarities to economic policies in the early 1950s and 1960s, but today's

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174. Business Tax § 16; Products Tax § 17; IEIT § 15.

175. For example, Consolidated Commercial Tax (Implementing Provisions) 1958, § 33.

176. Nov. 19, 1982, DIGEST OF LAWS OF THE PEOPLE'S REPUBLIC OF CHINA (1979-1984) 356.

177. Suspension or revocation of a license must be approved by the head or deputy head with special functions of the local bureau of the SAIC. SAIC Regulations Concerning Individual Enterprises, *supra* note 122, § 10.

178. Civil Law § 121.

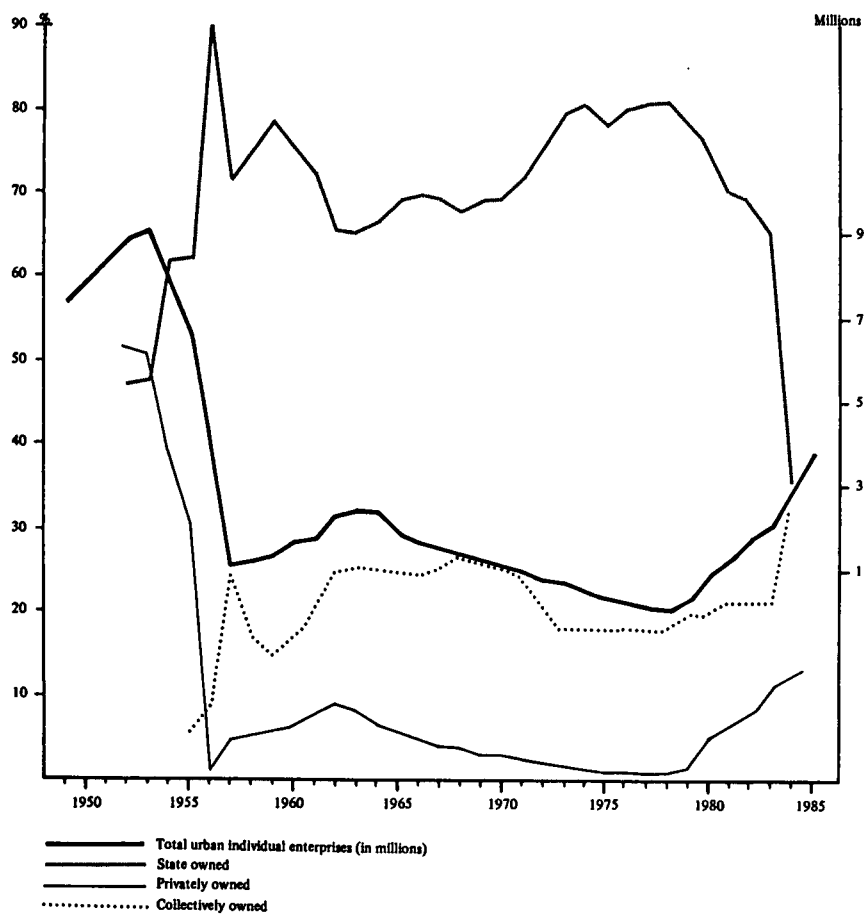
economic and legal environment is fundamentally different. First, despite its remarkable speed of growth, its important contribution to the tertiary sector, particularly in commerce and service trades, and its creation of employment opportunities, individual enterprise is but a tiny island in the vast ocean of public ownership. Second, individual enterprise has never been so openly and so thoroughly defined and regulated by law as it is in China today. Nevertheless, complex legal issues remain, particularly in respect of an individual enterprise's legal status and liability under the Civil Law. Left unsolved, however, these problems may well prevent individual enterprise from realizing its full economic potential. Finally, the economic success of individual enterprise in China has proven the value of private initiative in economic activities. This is an object lesson for reformers who would now attempt to "privatize" uneconomic parts of the public tertiary sector.

FIGURE A

Commerce, food and beverage trades and other service trades from the early 1950s to 1984 analysed by form of ownership (in percent).

Total persons (in millions) engaged in urban individual enterprise from 1949 to 1985.

Source: Statistical Yearbook of China 1985





**FIGURE B**  
Total individual enterprises in 1983 and 1984  
according to households (bar graphs) and persons  
(pie diagrams) analysed by trades.

Principal source:  
Economic Yearbook of China 1985

