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Date August 18, 1997
Abstract

The experiment currently underway in developing securities markets in China have met with initial success, although, as has been mentioned throughout this thesis, there are a considerable number of issues still to be addressed over time. Many of the issues will probably be resolved by trial and error as various participants in the market -- the regulators, the exchanges, the intermediaries, the issuers and the investors -- develop more experience. Central to the problem of securities regulation in China is that none of the Western-style corporate and securities frameworks proved to be the essential vehicle for private Chinese economic development that their creators had envisioned. In responding to this question, this thesis concludes that China's new securities program is a process and must be recognized as such. In this process, the transformation of a system, inclusive of all sectors, that is wholly based on state ownership to one that functions by the rules of the marketplace, takes time and effort. The US model may be useful in certain contexts, but China's securities regulation should adhere to an approach compatible with its culture and reflective of its distinct political system and the humiliating history of the last two centuries. Chinese people, after many rounds of debate extending over more than a century, have come to realize the tremendous need for, and potential benefits from, building a strong country in favor of the Western style democracy and mode of regulation. The pace and uncertainty of this unique transition frighten as many Chinese as they embolden. Whatever the Chinese are on the way to becoming, the following counsel have to be offered: Naixin. Patience. Xuyao shijian. It takes time.
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Securities Regulation In China:
A Study Of Its Path To Market Economy

Introduction

The global wave of privatization started in Britain in the early 1980s, swept across Latin America, Eastern Europe and the former Soviet Union Republics,¹ and is now landing China. Because of differing circumstances and context, privatization schemes vary from country to country. China’s securities program, as the main part of privatization scheme, reflects this fact.

In the Chinese context corporatisation, literally, “stockification” (gufenhua), refers specifically to the transformation of state-owned enterprises (SOEs) into joint-stock companies, in which the state, or its agents, continue to hold the controlling interest. Thus, if we take privatization to mean the “transfer of ownership or control of assets from the public to the private sector,”² then although actual and constructive privatization is occurring in sectors of the Chinese economy, and may eventually occur in


large-scale SOEs, what has been happening to these enterprises over the last several years is not truly privatization.

Moreover, the notion of privatization remains ideologically sensitive. Indeed, in a recent interview, a senior Chinese economic official denied that privatization is 'the orientation for China’s enterprise restructuring” and insisted that ‘the joint-stock system is just a property organization form [that] does not mean private ownership” because the original state capital is not transferred. Smaller SOEs, acknowledged the official, may transfer original state-owned capital, but the state uses the proceeds to reinvest in the state-owned sector in order to insure that the state and collectively owned public sector retains its dominant position and leading role. Thus, the policy-makers continue to treat this transformation of the state sector as a process of corporatisation, not privatization.

In our fascination with China’s corporatization experiment, we tend to forget that it is the fifth in a line dating back to the beginning of this century. In 1904, during the last decade of the Qing dynasty, then in 1914, 1929, and 1946 under the Republican


4 On January 21, 1904, the Ministry of Commerce (Shangbu) issued China’s first Company Law (Gongsilu). The Company Law was the first modern law drafted by the Imperial Law Codification Commission, whose work was part of the Qing government’s reformist “new policy” in the wake of China’s recent humiliations at the hands of Japan and western powers. But as a means of encouraging the formation of new types of companies, the law was not a success. Although 227 companies had registered by 1908, only twenty-two were of significant size: these accounted for nearly half of the authorized capital of all registrants. See William C. Kirby, China Unincorporated: Company Law and Business Enterprise in Twentieth Century China, 54 J. Asian Stud.44 (1995).

5 Borrowing more directly from German commercial law, the 1914 Ordinance Concerning Commercial Associations (Gongsi Tiaoli) was a much more detailed (251 articles) and comprehensive set of
government, company laws were enacted. Yet as a recent study of these laws by Professor Bill Kirby cogently argues, none of these Western-style corporate law frameworks proved to be the "essential vehicle for private Chinese economic development" that their creators had envisioned. Of interest not only to historians, but also to the current experimenters, is why not? What is the difference between corporate/securities regulation in China and those in the western world especially the United States? Are there any possibilities that China's characteristics will be replaced by the American style in the future? In responding to these questions, this Comment concludes that China's new securities program is a process and must be recognized as such. In this process, the transformation of a system, inclusive of all sectors, that is wholly based on state ownership to one that functions by the rules of the marketplace, takes time and effort. The US model may be useful in certain contexts, but China's definitions and regulations than its predecessor. This law was much clearer than its predecessor in its basic regulations, and would serve as the foundation of future revisions of the law; but, as in 1904, its effect on the structure of Chinese enterprise would be small. See Kirby, supra note 4.

Although the 1929 Company Law (Gongsi Fa) was based on the 1914 Ordinance, ninety of its 233 articles were revised from its predecessor, in general mandating greater degrees of regulation on limited share companies and higher levels of punishment for transgressions. Its stipulations were so strict as, in the opinion of a legal scholar writing in the 1940s, "to prevent law-abiding people from developing their business". See Kirby, supra note 4.

The new law emerged with a revised set of categories linking the interests of the state with those of prospective foreign investors. To transform public enterprises into (state-dominated) companies, it created a new legal category of "limited company" (youxian Gongsi) with no more than ten limited-liability shareholders. Such a category fit the aims of postwar development in which the state would expropriate Japanese-owned industries on Taiwan, and reorganize them as companies in which the NRC would hold the majority share and be responsible for management, but in which provincial and local governments as well as selected Chinese and foreign investors might invest. To provide a legal basis for foreign firms operating in post-extrality China, the law also defined, for the first time, a "foreign company". The definition was crucial to the Chinese government's desire simultaneously to solicit and control foreign investment. See Kirby, supra note 4.

See William C. Kirby, supra note 4.
securities regulation should adhere to an approach compatible with its culture and reflective of its distinct political system and the humiliating history of the last two centuries.

This paper, by adopting comparative legal study method, analyses Chinese views on securities regulation and corporatisation in the context of economic, political and legal reforms. Chapter I examines the basic legal and political differences between the US and China in the area of securities regulation. Part II and Part III will review the different characteristics of the two styles of regulation respectively. Part IV explores the Chinese government's view on securities regulation from a historic perspective as well as the prospect of Chinese securities regulation.
Chapter I The Nature of Securities Regulation: Investor Protection v. Market Promotion

A. Two models of securities regulation

Securities Regulation is one of the oldest branch of consumer protection after usury laws. It turns moneylending and usury laws upside-down. For once it is the lender, not the borrower, who is seen as the gullible victim in need of the statutory shield. Obviously the shape of the shelter varies, but prior to a more elaborate review of the nature of securities regulation, it may be useful initially to summarize broadly its origin and its legal framework.

The genesis of regulation is to be found in England and the United States in the public indignation aroused by the discovery of some particularly scandalous abuse while in China from the desire of the authorities to foster the development of a public capital market. The content of the regulation is dictated by the reasons for its introduction. Thus legislation in UK and US seeks more to protect the investing public than to avoid

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discouraging red-tape and onerous disclosure requirements. China, on the other hand, has been focusing on creating competitive markets for professional investors rather than protecting private investors.

a. UK and US

In England the risks of investment were highlighted by the South Sea Bubble episode in the early 18th century.\textsuperscript{10} The bursting of the South Sea Bubble destroyed thousands in all ranks of society. Reputations in the financial and political world were ruined wholesale. And the national disaster was aggravated by the numerous hoaxes which were developed by imitators.\textsuperscript{11} The result of all this was enforcement of the vague and prolix ‘Bubble Act’ of 1720, which prohibited the use of false or irregular charters and the taking of subscriptions for such enterprises.\textsuperscript{12} With the growth of legitimate

\textsuperscript{10} The South Sea Company grandiosely sought to acquire the whole of the National Debt amounting to the then huge sum of $31,000,000 in exchange for holdings of the certain dubious operations in the South Sea. Every means were used to get in the holdings, including bribery. Royal personages were said to have been involved. See Louis Loss & Joel Seligman, Securities Regulation, Little, Brown & Company (1989).

\textsuperscript{11} In a few months about 200 joint stock schemes were started, calling in the aggregate for $300 million sterling, more than the value of all the land in Great Britain. A thousand persons are said to have paid two guineas each in one morning as a first installment on a share in a company ‘for carrying on an undertaking of great importance, but nobody to know what it is.” See Melville, The South Sea Bubble (1921) 97.

\textsuperscript{12} The statute’s recitals referred to ‘persons who contrive or attempt such dangerous and mischievous undertaking or projects, under false pretenses of publick good, do presume * * * to open books for publick subscriptions, and draw in many unwary persons to subscribe therein towards raising great sums of money, whereupon the subscribers or claimants under them do pay small proportions thereof.” See 6 Geo. 1, c.18, Section 18. It declared such matters to be a public nuisance subject to penalties and forfeitures. Brokers trading in such unlawful shares were rendered liable to lose their licenses. And (as if foreshadowing the American antitrust laws) merchants and traders whose business was injured by such unlawful organizations were given the right to sue for treble damages. The Bubble Act was gradually whittled away and finally repealed in 1825. See Loss, supra note 10.
corporate enterprise Parliament in the Companies Act of 1844 enacted the first modern securities requirement, introducing the principle of compulsory disclosure through the registration of prospectuses inviting subscriptions to corporate shares.\textsuperscript{13}

In 1890 Parliament passed the Directors Liability Act\textsuperscript{14} (subsequently incorporated into the Companies Act), whose purpose was to modify the common law of deceit, as it had been applied by the House of Lords the previous year in Derry v. Peek,\textsuperscript{15} so as to subject corporate directors and promoters to civil liability for untrue statements in the prospectus without proof of scienter. Both case law and statute have since supplemented this provision and the present protections are contained largely in the Companies Act 1948, the Prevention of Fraud (Investment) Act 1958 and, for United Kingdom listed issues, the regulations of The London Stock Exchange. After the financial reform of 1986 Securities & Investment Board (SIB) was established under the Financial Services Act to institutionalize and further strengthen the anti-fraud function of financial regulation.

\textsuperscript{13} This Act followed a landmark report (the first of a series of such reports about a generation apart) by a Select Committee on Joint Stock Companies under the chairmanship of Gladstone, who was then the President of the Board of Trade.

\textsuperscript{14} 53 & 54 Vict., c.64.

\textsuperscript{15} 14 A. C. 337 (1889):

The defendant’s prospectus stated that the company had the right to use steam or mechanical motive power, instead of horses. This was incorrect because the company’s special Act of Parliament made that right conditional on the consent of the Board of Trade which was refused. However, the plaintiff lost the case since he was unable to prove that the defendant had made the misrepresentation knowingly or recklessly.
In the United States one may commence with the activities of a Mr. J.N. Dalley, a retired grocer and bank director who was appointed Bank Commissioner after the Populist Party's success in Kansas in the 1910 election. Mr. Dalley took it upon himself to introduce an informal system of scrutiny and sent potential investors unsolicited warnings about securities he considered suspect. Not satisfied with this haphazard method, he subsequently instigated the passage of an Act in 1991 which required that no security covered by the Act could be sold in Kansas unless a permit had been issued by Dalley's office. This paternalistic approach was followed by many other states and within the next two years 23 states had enacted regulatory laws and all but six of these were either the same or based upon the Kansas statute. Their constitutionality was finally settled by the United States Supreme Court in 1917. These laws came to be referred to as "blue sky" laws, a term which came into being because, it was said, Kansas


17 For details, see the "merit regulation" part of Chapter Two.

18 See Merrick v. Halsey & Co., 242 US 568 (1917); Caldwell v. Sioux Falls Stock Yards Co., 242 US 559 (1917); Hall v. Geiger-Jones Co., 242 US 539 (1917). Of these three cases, only the Michigan statute in Merrick represented a true test case for the securities industry; the other two, to the dismay of securities industry strategists, involved the sort of fly-by-night enterprises that the blue sky laws were ostensibly designed to prevent. Writing for the Court in Merrick, Justice McKenna held that it was within a state's police power to prevent deception in the sale of securities. The statute admittedly burdened honest businesses, but only so that "dishonest business may not be done." Although this might admittedly cause expense and inconvenience, said McKenna, "to arrest the power of the state by such considerations would make it impotent to discharge its function. It costs something to be governed."

With respect to the alleged burdens on interstate commerce, the Court observed that the statute in question applied only to dispositions of securities within the state. "Upon their transportation into the state there is no impediment." Thus, because the statute in question affected the securities in question only when a disposition of them was attempted within the state, the interference with interstate commerce was "only incidental" and therefore within the state's constitutional authority.
was full of promoters of fraudulent enterprises whose frauds were so barefaced that they
would be prepared to sell building lots in the blue sky in fee simple.\textsuperscript{19}

However it was not until 1933 that the federal legislature enacted a statute
implementing a comprehensive system of securities law controlling disclosure at the
federal level. The impetus to introduce such a system arose as a result of the Wall Street
crash of 1929 and the subsequent exposure of some highly questionable securities
practices. The Securities Act of 1933 is a disclosure and anti-fraud statute primarily
affecting the distribution of securities. It was followed by the Securities Exchange Act
of 1934 which set up a licensing system for dealers, established the Securities and
Exchange Commission\textsuperscript{20} to monitor securities laws and concerned itself with promotion
of fair and equitable trading practices in the securities market.

b. China

In December 1978, the Third Plenary Session of the 11th Central Committee of
the Communist Party of China ('CPC') simultaneously launched a policy of economic
reform and opened China to increased contacts with the outside world.\textsuperscript{21} One of the

\textsuperscript{19} Thomas Mulvey, Blue Sky Law, 36 Can. L. Times 37, 37 (1916).

\textsuperscript{20} Initially the administration and enforcement of the Securities Act of 1933 was by the Federal Trade
Commission.

\textsuperscript{21} For an overview of China's economic reform and open-door policies, see Elizabeth J. Perry &
Christine Wong, The Political Economy of Reform in Post-Mao China, Harvard University Press (1985);
see also Harry Harding, China's Second Revolution: Reform after Mao, Brookings Institution (1987).
primary goals of China's current economic reform program is to invigorate the tens of thousands of state-owned enterprises (SOEs). SOEs are one of the greatest burdens on the Chinese economy to date, draining millions from the central coffers each year. The core issue over this reform was how to let SOEs make their own decisions and achieve independence from the government, which had been managing and administering those enterprises through orders and instructions under a highly-centralized, planned economy.

Before 1992, various measures have been implemented by the state government to reform the SOEs. Due to the ideological sensitivity of private property rights, the concepts of shareholding system and stock markets have gradually evolved in the context that commodity economy can be used to supplement the planned economy. In the beginning, the government advocated a contract system (chengbao zhi) where, basically, the enterprises would negotiate contracts with the government to arrive at a mutually agreeable amount of annual production to be completed and percentage of profit to be retained by the enterprises. Then, a system of property management responsibility.

22 According to the documents of State Commission on Restructuring Economics System (SCRES), There are 108,000 SOEs in China and over 50% are operating at a loss, while returns have been dropped steadily to 1.9% in 1993 from 11.9% in 1985. SOEs account for close to 60% of GDP, but contribute a shrinking share of industrial output, close to 48% today as compared to nearly 80% in the late 1970s. The average debt-equity ratio of all SOEs was over 80% by the end of 1995, as compared to the same ratio at around 20% in 1987. SOEs employ over 108 million people, but if one includes dependents, approximately 340 million Chinese owe their livelihood to state firms. While SOEs represent a huge force in the Chinese economy, the cost of maintenance is simply too high and cannot be sustained.

23 Certain Measures Concerning the Expanding Operative Administration Autonomy of State Enterprises; Regulations on the implementation of Profit Retention in State-owned Enterprises; Provisional Regulations on the increase of Depreciation Rates on Fixed Capital and Improvement of the Use of Depreciation Fees in State-owned Industrial Enterprises; Provisional Regulations on Levyng Fixed Capital Tax in State-owned Industrial Enterprises; and Provisional Regulations on Bank Loans for the Full Quota of Working Capital in the State-owned Industrial Enterprises. Zhonghua Renmin
and management targets responsibility (jingying mubiao zeren zhi) were introduced, in which the government would set certain targets for enterprise managers to achieve during their year in office. Eventually, faced with the failures of the those measures, both the intelligentsia and reform-minded entrepreneurs came to realize that the solution for more efficiency contained two major components: the separation of the ownership and management in the SOEs and the corporatisation/privatization of SOEs' ownership. Much effort was made for the transformation of SOEs into shareholding companies and the establishment of securities markets during this period of time.24

The economic reform program received greatest impetus in early 1992, when Mr. Deng Xiao-Ping made his famous tour of southern China. During that trip Mr. Deng made it clear to the Party and state leaders that reform was still to be the main theme of the country, and only by continuing the reform policy could the Chinese people accept the legitimacy of the Communist Party leadership. Mr. Deng’s statement immediately removed any remaining conservative trends, eliminating any lingering fear of ideological

24 In the early stages, state and other corporate entities (mostly state-owned enterprises) held the majority of the stock, while individuals (initially restricted to employees, but gradually extended to the public) held minority positions. These early experiments were carried out without very much legislative support. Public trading of stock began in 1986 when over-the-counter trading centers were established in two major industrialized cities, Shanghai and Shenyang. Two organized stock exchanges opened for business in Shanghai and Shenzhen in December 1990 where 13 companies with a total capitalization of RMB240m (CN$1=RMB6) were listed.
backlash\textsuperscript{25} and resulted in the adoption of "socialist market economy" by the 14th Congress of the CPC held in October 1992.

The Political Report\textsuperscript{26} delivered by President Jiang Zemin declares that economic reform must be accelerated towards the central task of establishing a "socialist market economy". To achieve this, four goals are outlined by the Report: (1) to change the way in which state-owned enterprises operate, especially the large and medium-sized ones, and to push them into the market so as to increase their vitality and efficiency; (2) to establish a market system, that is, to establish markets for the trading of bonds, securities, labor, technologies, information, and property, and to reform the price system; (3) (omitted); (4) to change the functions of government departments, that is, to confine government functions to areas of overall planning, policy control, supply of information, co-ordination, supply of services and supervision.\textsuperscript{27} Shortly after the landmark meeting of CPC, a Constitutional Amendment was adopted by the First Session of the Eighth National People's Congress on 29 March 1993, which substituted "socialist market economy" and "state-run enterprises" for "planned economy" and


\textsuperscript{26} See "Accelerating the Reform, the Opening to the Outside World and the Drive for Modernization, so as to Achieve Great Success in Building Socialism with Chinese Characteristics", People's Daily overseas edition (Renmin ribao haiwai ban), 21 October 1992, at 1-3.

\textsuperscript{27} These goals and ways to achieve them are further elaborated in Decision of the CPC Central Committee on Some Issues Concerning the Establishment of a Socialist Market Economic Structure, People's Daily overseas edition (Renmin ribao haiwai ban), Jan. 1993.
There is no doubt that it is the new guiding ideology that paved the way for a national securities regulatory framework.

The current two-tier system (SCSPC\textsuperscript{28}--CSRC\textsuperscript{29}) for supervising and regulating the securities markets in China is established pursuant to the Notice from the State Council Regarding the Further Strengthening of the Overall Administration of the Securities Market, circulated in October 1992.\textsuperscript{30} For the time being, The State Council Interim Regulations of Share Issuance and Trading (The Interim Regulations)\textsuperscript{31} and The Company Law\textsuperscript{32} function as the national securities and corporate law governing China’s

\textsuperscript{28} The State Council Securities Policy Committee is a joint conference that meets from time to time for the purposes of formulating general policies and carrying out the overall macroscopic administration of the national securities market in China. It is comprised of ministers from 16 ministries under the State Council. During the past 4 years of development of the securities market, the SCSPC has played a limited role even though it is supposed to be formulating the policies and programs to guide the overall development of the securities market, organizing the initial drafting of laws and regulations related to securities market and coordinating and supervising all the activities involving the exercise of regulatory power. It is also supposed to oversee the management of the CSRC.

\textsuperscript{29} The China Securities Regulatory Commission is a “semi-governmental agency” authorized by the State Council to be responsible for regulating China’s domestic securities and futures markets and supervising overseas listings of Chinese companies. Aside from the CSRC, there are provincial-level securities and futures commissions throughout the country. However, only the local regulatory commissions in Shanghai and Shenzhen actually play some meaningful functions in those regards. Prior to the establishment of CSRC the local branches of the central bank, People’s Bank of China were responsible for market regulation. For detailed information, see “Document No. 68”, infra note 30.

\textsuperscript{30} This is commonly referred to as ‘Document No. 68”. See People’s Daily, October, 1992; it was also reprinted in Compilation of New Laws, 1992, no.4, at 262.

\textsuperscript{31} Promulgated on 22 April 1993 and made public at People’s Daily of 4 May 1993.

\textsuperscript{32} The enactment of the Company Law in December 1993, with all its defects and inadequacies, ended the history of China’s SOE reform without a proper law. The predecessor of the law, the Standard Opinion, was never fully recognized as an authoritative document. The past 4 years have seen several lower-level regulations promulgated, to fill in the legal lagunas created by the Company Law. The more important ones include:

* the H share regulations and the mandatory articles of association for H share companies;
domestic markets. The regulation of foreign-related shares, B\textsuperscript{33} and H\textsuperscript{34} shares are based on the respective regulations as enforced by the CSRC.

B. The Legal Concept of Securities Regulation in China: Economic Law

It is not difficult to see, as shown above, that the changing fate of SOEs reform measures in China lies directly with the need, as perceived by the Party leadership, for national economic development. For both Deng Xiaoping and current Party leaders, therefore, law must be used to establish stability and order for economic development.\textsuperscript{35} Against this background, Chinese scholars emphasize that law is in fact an important and necessary tool for implementing Party policies:

* the B share regulations and the upcoming implementation rules;
* the The Ministry of Foreign Trade & Economic Cooperation (MOFTEC) rules regarding joint stock companies with foreign investment;
* the state share management rules;
* the amended criminal code for corporate offense; etc.

\textsuperscript{33} Shares that are offered to and traded by foreigners in hard currency on one of the two Chinese stock exchanges. See Regulations of the State Council concerning Foreign-investment Shares Listed Domestically by Companies Limited by Shares, China Securities Daily (Zhongguo zheng quan bao), 4 January 1996.

\textsuperscript{34} Shares being traded on the exchanges of Hong Kong or other foreign countries, see Special Regulations of the State Council concerning Floating anf Listing of Shares Overseas by Companies Limited by Shares, China Securities Daily (Zhongguo zhengquan bao), 4 August 1994.

\textsuperscript{35} See e.g. Deng Xiaoping, Implement the Policy of Readjustment, Ensure Stability and Unity, in Selected Works of Deng Xiaoping, Foreign Languages Press (1984), at 335-355. See also Communique of the Third Plenary Session of the Eleventh Central Committee of the CPC, in Selected Readings of Important Documents since the Third Plenary Session of the Eleventh Congress of the CPC (Shiyijie sanzhong quanhui yilai zhongyang wenxian xuandu), (Beijing: People’s Press, 1987), at 10-11.
Law is the fixation and codification of policy. It is necessary to stabilize in legal form Party policies that in practice have repeatedly proven their effectiveness and whose implementation should be continued.\textsuperscript{36}

More importantly, Chinese scholars believe that law is a better tool than policy, capable of securing and institutionalizing ad hoc policies in a more universal manner, of providing stability and order, through state coercive forces, for economic development and of defining rights and duties in relation to the state, represented by various administrative authorities.\textsuperscript{37} The development of securities regulation, as part of the economic law, in the PRC therefore can only be understood in the light of its designated role.

The development of economic law in the PRC in the last decade or so has generally followed a two-stage process: In the first stage, economic activities are authorized through ad hoc administrative measures. These measures often take the form of Party and/or state policy statements and interim administrative regulations issued by


the State Council or its ministries and commissions. In the second stage, those issues that are seen as ripe, after experience has been gained through the implementation of various policies, are then formally legislated by the central legislative authorities, namely the National People's Congress (the NPC) and its Standing Committee. In fact, law is generally designed to confirm those policies which have been seen as having been successful in practice and as serving the goals of reform. Such a practice means that private legal rights as they are understood in the West first appear in the form of administrative authorization. Since the making of economic law in the PRC remains largely unfinished to this day, many traditional private rights remain in the form and in the nature of administrative authorization.

The unique nature of such private rights, together with the frequent use of Western private law institutions and expressions in these laws, has created many practical difficulties and problems as well as theoretical debates within the PRC concerning the concept of economic law. The debate between civil law schools and economic law schools started around 1979 when theories concerning civil law and economic law began to emerge.

Although there were different theories concerning the concept of civil law, the majority of jurists soon began to accept the "commodity relations theory". With regard to the concept of economic law, although many theories emerged, a main strand can be identified. This was advanced in the 1979 Forum on Civil and Economic Law sponsored by the Institute of Law of the Chinese Academy of Social Sciences, and soon developed into the so-called "Vertical-Horizontal Relations Theory" of economic law. The debate is how to allocate economic relations to these two areas of law and whether economic law, having covered some economic relations, could become an independent branch of law.

According to the "commodity relations theory", civil law should regulate socialist commodity relations. These commodity relations include the specific area of property

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40 The Commodity relations theory was developed to challenge the 1950s' conception of civil law in the PRC which dominated Chinese civil law circles until the late 1970s. Chinese jurists in the 1950s followed the view widely held in the former Soviet Union and other socialist countries and defined civil law as a branch of socialist law regulating property and personal non-property relationships. However, the Chinese definition of civil law in the 1950s deliberately omitted the emphasis found in other socialist countries that "the main method of regulation assumes a commodity form". Such an omission reflected the denial of the existence of a commodity economy in socialist China both in theory and in practice. Also missing from the Chinese notion of civil law at that time were such fundamental private law principles as equality and autonomy of civil law parties.


42 Although various theories emerged in the ensuing years before 1986, the main elements were always present even if emphasis varied and a variety of terms for the theories appeared. For instance, there were the "Management-Cooperation Theory", the "Management-Operation Theory" and the "Macro-Micro Economic Relations Theory". Essentially, management relations refer to vertical and cooperation (or operation) horizontal relations, while macro-economic relations are those arising during the process of economic management by the state and micro-economic relations are internal relations between socialist economic units.

relations and personal relations which arise among citizens, and among economic organizations, as well as between citizens and organizations. Scholars advocating this theory emphasize that parties to civil law relations are on an equal footing and have certain freedoms in forming civil law relations. As to the "Vertical-Horizontal Relations Theory", the essential elements are twofold. First, the economic relations regulated by economic law are both vertical and horizontal. Vertically, they include relations between economic units and their superior organs; horizontally, they include relations between economic units. Secondly, participants do not have equal status, and state intervention, either through state economic plans or through administrative measures, is present in many cases if not always. Civil law scholars do not generally deny the existence of economic law but reject the idea of creating an economic code and treating economic law as an independent branch of law.

44 Id, at 14.

45 Id, at 15-16 and 20-23.

46 Professor Tong Rou of the Chinese People's University said:

General provisions of civil law (as is also true of administrative law, financial law, labor law, criminal law, and other basic branches of law) do not cover all specific circumstances and requirements of every economic process (such as capital construction, transportation, resources protection, etc.), and these have to be dealt with through other laws in the form of economic law...[however], economic law being composed of norms of various branches of law, whether as a whole or individually, does not constitute an independent branch of law. It lacks its own method of regulation. Tong Rou, "The Object of Civil Law and the Relationship between Civil Law and Economic Law", in "Academic Forum on Economic and Civil Law", Studies in Law (Faxue yanjiu), (no.4, 1979) at 16-17.

Professor Wang Jiafu of the Institute of Law of the Chinese Academy of Social Science further explained:

Once a civil code and other economic rules and regulations are made, there is no need to make an economic code. This is because: firstly, it [economic law] has no unified object nor unified method of regulation. Secondly, it would easily and excessively strain administrative methods in managing the economy, which would be disadvantageous to economic reforms which has just started. Thirdly, its contents would be repetitious, and the unified economic activities participated in by [economic] units
Among the issues between the two schools, the problem of how to allocate them in regulating the horizontal economic relations remained unresolved until the adoption of the General Principles of Civil Law of the People's Republic of China (GPCL) in 1986. In his Explanation on the Draft of the GPCL addressed to the NPC, Mr. Wang Hanbin, one of the chief drafters, said:

The draft provides that the general principles of civil law of the People's Republic of China shall regulate property relationships and personal relationships between civil subjects with equal status, that is, between citizens, between legal persons and between citizens and legal persons. This provision has two basic principles. Firstly, a large portion of civil law reflects commodity economic relations; the parties to a commodity exchange [relation] must have equal status and rights...Secondly, the civil law primarily regulates property relationships between equal subjects, that is the horizontal property and economic relationship. The administration of the economy by the government, vertical economic relationships or administrative relationships between the state and enterprises and within enterprises are economic relations but not between equal parties, and they are governed by relevant economic law and administrative law. Therefore, civil law does not provide any provisions [on these matter].

The importance of this explanation is that, under the Chinese theory of law, an explanation given by a law drafting organ to the NPC and approved by the NPC is a kind of legislative interpretation of law and has the same legal forces as that of the law itself.

and individuals will have to be artificially separated. Wang Jiafu, "Civil Law Must Be Made", in "Academic Forum on Economic and Civil Law", Studies in Law (Faxue yanjiu), (no.4, 1979), at 21.

47 An English translation of the full text of the Explanation can be found in China Law Yearbook 1987, at 147-152.

Economic scholars saw it as a twofold blow to their arguments and theories. First, horizontal economic relations were exclusively under the scope of civil law. Secondly, in the area of vertical economic relations, economic law did not have a secure jurisdiction either, rather it had to share a role with administrative law whose scope was rapidly expanding but remained unclear.

Faced with this unexpected legislative outcome, economic law scholars did not concede that economic law is no longer an independent branch of law. On the contrary, after a few years of silence, a so-called ‘Economic Administrative Law Theory” was established to explain the relationship between economic law and administrative law.

In contrast with the debate between “civilist” and “economists”, there has not been either extensive or intensive debate between the economic law school and the administrative law camp. The reason is that the Party appeared to see administrative law as an

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instrument for political reform, or more precisely reform in the organizational and personnel systems, and thus effectively left a large number of administrative rules and regulations concerning economic matters under the jurisdiction of economic law. This Party policy is evidenced in the Party Report delivered at the Thirteenth National Congress of the CPC in 1987 by the former Party Secretary-General Zhao Ziyang. In his Report he said:

To consolidate the achievements of structural reform and to institutionalize administrative management, we must improve administrative legislation, drawing up basic norms and procedures for administrative work. We should improve current regulations governing administrative organs and formulate rules specifying their size, in order to control the establishment of such organs and their manning quotas through legal budgetary means. We should devise an administrative responsibility system at various levels to improve work quality and efficiency. We should formulate an administrative procedural law, strengthen supervisions over administrative work and personnel, and investigate cases of neglect or dereliction of duty and other breaches of law or discipline by administrative personnel.  

This message was received with relief by many “economists” as they interpreted it to mean that the scope of administrative law was to be confined to the political sphere, i.e. to areas of administrative organization, administrative liability and administrative litigation, but not applicable to the economic sphere. Since the adoption of the notion of “socialists market economy” in late 1992, state macro-control and regulation of the

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52 See Xie Cichang, supra note 49, at 38.
market have been increasingly emphasized by “economists” as the main contents of economic law. Gone is the notion of state control of the economy as a part of economic planning; emphasis is now on the importance of fair competition and orderly economic development through macro-control and regulation by the state. Essentially, however, the central idea of economic law remains the same: economic law is about state intervention in (or administration of) the economy.  

The “Economic Administrative Law Theory” has now also gained the support of “civilists”. However, the problem with this “settlement” between economic law and administrative law is obvious. As admitted by some Chinese jurists, separating out the state functions in politics and the economy is a formidable task both in theory and in practice. State power, exercised by the Party and various administrative authorities, extends to every sphere of social life, and political and economic means are always intermingled in the management of the economy by the state. Consequently, if a code...  


55 This problem is well acknowledged by many “economists” in China, see e.g. Liang & Wang, supra note 54, at 212-213.
on general economic law principles is to be enacted, as still advocated by many economic law scholars, drawing a line between economic and administrative law will become a major problem for economic scholars. Besides, it is particularly dangerous when such allocation neither try to further study the relationship between economic law and administrative law nor relate economic law to the nature of democratic government and politics.

In sum, the two attempts to define economic law in the PRC share two common features. First, all two attempts emerged during a time when the Party decided to shift its focus from political campaigns to economic and political reform. Secondly, economic law was reshaped by Party policies during each attempt. Both features show the important role of the Party in the development of economic law in the PRC: The former indicates that the fate of economic law in the PRC depends on the Party policy’s emphasis on economic and political reform; the latter demonstrates that the Party’s tolerance towards economic and political freedom decides the scope or usefulness of economic law in the PRC. It is clear that the main functions of Chinese theories in

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economic law development in the last decade or so have been to interpret, and to justify
the introduction of, various policies, administrative measures and practice. As a result,
the two attempts have been unable to deal properly with the role of the state and
administrative organs and authorities in the economic sphere, and hence with the use of
administrative rules and regulations by the state to regulate and manage economic affairs.

C. The Legal Concept of Securities Regulation in the US: Administrative
Law

Before my detailed discussion of the US securities regulation, I would like to
stress that in the US we should look at securities law as a system rather than as a single
law, just like most of civil law and Chinese law scholars do. As to what constitutes the
general domain of securities law, I would suggest that we might envision the system to
consist of concentric rings:

Frist, I would suggest that at the centre ring is the general law which determines
the basic relationship between parties involved. I would regard the domain of the
administrative law as constituting the foundations of the American system of securities
law. Second, at the second ring should be one or more (preferably one) law which deals
specifically with the regulation of securities markets. This is what most countries call
"securities law" but I put this at the second ring because at the centre of all things is the

57 See Glendon, Gordon & Osakwe, Comparative Legal Traditions, West Publishing Co., at 23.
administrative law. Third, further out from the centre are all other laws which affect rights, obligations and duties in relation to securities markets. For the purpose of illustration, the joint stock company law, laws and regulations relating to accounting standards and valuation of property, bankruptcy law, constitutional law, and laws and regulations relating to banking particularly in relation to the provision of credit and negotiable instruments.

Practitioners and legislators should not forget that no specialised securities law stands alone. Therefore, they should not forget to take account of developments in the civil law and other law relating to financial markets. But since the legal concept of securities regulation relates most to its foundation, let me now explore the centre ring and also the relationship between the centre ring and the second ring.

In the US, scholars made another distinction which served to locate the concept of securities regulation and explain how securities laws are administered by SEC, one of the major administrative agencies. This distinction was between “general” administrative law, which pertained to those procedural questions common to most agencies, and “special” administrative law, which pertained to the substantive law made by SEC and any unique procedures used. According to some scholars, this distinction was made, for law students, on the “practical” ground that it was “truly impossible to present both the general and all the specialized law in one book, nor could it be taught in one law school.
course". As a result, "specialized" questions were left for specific subject matter courses such as securities regulation. This distinction was further supported by the reform proposals produced by critics of SEC. Some critics have adopted a substantive orientation and have pursued deregulation as their objective. Others have adopted a procedural orientation and have pursued changes in the nature of judicial review, congressional oversight, or executive supervision as their objective.

Unlike China, the US has taken the establishment of "rule of law" as an end in itself rather than an instrument of Party policy. The notion of "general and specialized administrative law" is an indication that American system tries to emphasize the very foundation of securities regulation, i.e., to legitimize securities regulatory decisions as being democratic by placing them within the context of the definitions of democracy. The role of administrative law, as the US has evolved it, can be discharged only in a democratic society; it is that kind of society alone that is really willing to submit its conflicts to adjudication and to subordinate power to reason. Only in such a society can an administrative law system perform its basic function of protecting the individual against government.

The principles of American democracy are built on the "liberal" philosophical and political movements that came to dominate England and Europe in the three centuries before the USA was founded. Liberalism attacked the economic and social restrictions that had grown out of feudalism on the ground that if people were given liberty to learn, to think, and to act, they would be led to the formation of a better society. Liberalism therefore promoted the values of liberty, natural rights, and government by consent. Under this definition, administrative agencies such as SEC would comply with democratic principles as long as their operation was consistent with the concepts of government by consent, by rule of law, and by separation of powers. Agencies thus would have to be accountable to popularly elected officials, operate according to legal procedures that provided for due process, and not involve the combination of legislative, executive, and judicial functions.

The role of administrative law in the development of regulatory policy was originally thought to be to ensure that the process was consistent with the "liberal" values of the classical model of democracy. The reality, however, is different. Due to the rather typical broad and vague delegations of legislative authority, the imposition of

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administratively determined sanctions will not be confined, except in a broad sense, by the rules that control agency action. The agency, not Congress, will make the policy decisions significant to a regulatory program. Moreover, these broad and vague delegations make it difficult for the judiciary to determine whether an agency has acted within the boundaries of its legislative mandate. For instance, according to the Administrative Procedure Act ⁶² (APA) and relevant organic act, three types of procedures potentially available to agencies were set forth: formal adjudication, formal rulemaking and informal rulemaking. The APA does not, however, limit an agency’s power to select procedures in accordance with their functionally based distinctions.⁶³ Thus, an agency can use informal rulemaking procedures to resolve a factual controversy between individuals or between the agency and an individual unless Congress has required it to use formal rulemaking. Similarly, an agency can establish general rules applicable to large groups of people through an order issued in a proceeding conducted as formal adjudication. This combination of executive, legislative and judiciary functions will make administrator have more discretion to interact with interest groups because the results of any bargain can be more easily defended as being consistent with vague and broad limitations, than with specific and narrow constraints.⁶⁴ If these changes are to be


⁶³ Formal adjudication is best-suited to one class of agency actions—resolution of factual disputes between individuals or between an agency and an individual. See 5 U.S.C. Section 556 (d). Informal rulemaking is best-suited to another class of agency actions—establishment of rules applicable to large groups of people. See 5 U.S.C. Section 553 (b).

considered as consistent with a democratic regulatory process, then they must be
defended within the context of “pluralistic” democracy.

Under the pluralistic definition, despite the violation of the liberal model,
decisions are still considered to be democratic in this explanation because the public is
represented by various political activists, like interest groups. As long as the interests of
a representative section of citizens are expressed in this fashion, the pluralistic bargaining
process would produce a reasonably just and stable division of the benefits and burdens
of the country’s social and economic life. In the pluralistic concept, agencies are but
one of the various interest groups that participate in the bargaining process. Agency
government, however, must have a structure that facilitates the bargaining process, so
that the power of agencies is checked by the power of the groups with which they must
bargain. Government must be structured therefore to require the participation of groups
in the decision-making process. Further, government must be open, rather than
secretive, so that groups find out what actions are contemplated and seek to support or
oppose those actions as warranted.

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65 See R. Dahl, Pluralistic Democracy in the United States (1967); R. Dahl & C. Lindblom, Politics,
Economics & Welfare (1953); R. Dahl, Preface to Democratic Theory, University of Chicago Press
(1956); see generally, D. Truman, The Governmental Process, New York: Knopf (1955); J. Schumpeter,

66 D. Yates, Bureaucratic Democracy: The Search for Democracy and Efficiency in American
The pluralists’ attempt to legitimize the existing set of political arrangements has been challenged on the ground that the theory in effect justifies the delegation of governmental decision-making to private parties. Since decisions are reached by a bargaining process, the role of public officials is to arrange the necessary negotiations. Thus, in this system, there is no necessity for public officials to make an independent judgment of whether the public interest has been served. As a result, a discontinuity between politics and government is created whereby policy is made free from the restraints imposed by the classical definition of democracy, which assumed that public policy would be made by elected officials. The net result is that the policies that have been developed have better served private interests than the public interest.  

The conflict over how to define democratic government is important for both general administrative law and specialized administrative law. If the liberal conception is considered essential to promote the public interest (for instance, the protection of private investors in the context of US securities regulation), then the role of administrative law, as an essential element of the classical model, should be increased and strengthened. If the pluralistic conception is considered sufficient for regulation to be considered legitimate, then the role of politics can be increased. The history of administrative regulation has seen a shift away from a process that was more consistent

with the classical model to a process that is more consistent with the pluralistic model. This shift has caused considerable interest in administrative law reforms which would attempt to return the regulatory process to a situation more consistent with the classical model. Whatever changes might be adopted, the problems which underlie the classical and pluralistic concepts would remain: Reforms that increase the responsiveness of the interest group process are also necessary to have a democratic regulatory process. Thus, issues like whether public interest groups should be paid to participate in regulatory hearings are central to the improvement of the regulatory process.

In sum, the concept of securities regulation in the US is characterized by the following features: First, due to different classification of legal concepts between China and the US, American legal scholars generally recognized securities regulation as part of administrative law rather than an independent branch from administrative law. Secondly, the debates between "liberal" and "pluralistic" schools are all centered around the relationship between administrative law and democracy. Both schools agree that

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70 Even in Civil law countries such as Germany and France, financial law is also thought to be part of administrative law. Today, when one speaks of public law in the civil law system, what is meant is often merely administrative law. Constitutional law, as it pertains to the form and structure of the state and its organs, is still regarded as being akin to political science. It is only in relatively recent times that courts or other institutions have acquired the power to review the constitutionality of the acts of government. As for criminal law, though technically classified as public law, it has traditionally been the concern of the "privatists" and everywhere falls within the jurisdiction of the ordinary courts. Thus, the bulk of public law in civil law countries in fact consists of administrative law. See M. A. Glendon, M. W. Gordon & C. Osakwe, Comparative Legal Traditions, West Publishing Co.104 (1984).
administration is an inherently political process regardless whether the public interest is represented by the elected bureaucrats or interest groups. Thirdly, in contrast to the theory of the detached “Economic Administrative Law” in China, US scholars believe, as shown above, that politics cannot be legislated away and political influences can be regulated, or moderated. These conclusions never caused alarm since the political system is itself democratic. On one hand, administrative law and process cannot be superior to the system that produces it. As Professor Bernard Schwartz put it: ‘it is the attitude of the society and of its organized political forces, rather than of its purely legal machinery alone, that is the controlling force in the character of free institutions.”

On the other hand, the authority of government comes to depend upon the outcome of political processes and the legitimacy of government is invigorated by the play of politics as codified in a system of laws.

D. The Nature of Securities Regulation: Right v. Interest

The reason for dealing with the concept of securities regulation differently in US and China is that western scholars draw a sharp distinction between rights and interests, while rights tend to be conceived of (at least implicitly) as interests in China.

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In the west, the most common way to state the difference between interests and rights is to assert that rights are deontological in character, whereas interests are consequentialist or utilitarian. That is, rights are moral principles, and as such are ends in themselves. Put differently, rights precede interests, both in the sense that rights trump interests and that rights are based not on utility or social consequences but on moral principles whose justification is derived independently of the good. As trumps, rights imposed limits on the interests of others, the good of society, and the will of the majority.

Central to this theory is the view that humans are autonomous moral agents who through a rational faculty are able to make the correct moral choices. Respect for the

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73 Linguistically, the Chinese term for rights is *quanli*. The second character, *li*, means interest, benefit, or advantage; hence *liyi*, "interest," as in a legal "interest." Traditionally the root *li*, connoted not merely interest but a selfish interest. See David Hall & Roger Ames, Thinking Through Confucius, State University of New York 93 (1987). Thus, *li*, was juxtaposed with *yi*, which connoted normative appropriateness or rightness. *Li* was also associated with *si*, which means private or personal, and by extension, biased, partial, and selfish (as in *zisi*).

Article 51 of the present Chinese Constitution states that "the exercise by PRC citizens of their freedoms and rights may not infringe on the interest (*liyi*) of the state, of society, and of the collective, or on the lawful freedoms and rights of other citizens." See Zhonghua renmin gongheguo xianfa [Constitution of People's Republic of China] art. L1 (1982). Earlier constitutions, including pre-socialist ones, contained similar provisions. See Andrew Nathan, Political Rights in Chinese Constitutions, in R. Randle Edwards ET AL., Human Rights in Contemporary China, at 77, 88-94. Implicit in the normative statement that one's rights may not infringe or harm the interests of others is the assumption that a right is simply another kind of interest. Clearly then, the Chinese conception of rights is not the powerful anti-majoritarian trump of Dworkin and Rawls that protects the individual against the state's pursuit of its own broad interests.

74 In Dworkinian terms, "a right is a claim that it would be wrong for the government to deny an individual even though it would be in the general interest to do so." see Ronald Dworkin, Taking Rights Seriously, Harvard University Press 269 (1977). And in Nozickian terms, "individuals have rights and there are things no person or group may do to them." see Robert Nozick, Anarchy, State, and Utopia, Totowa, N.J.: Rowman & Littlefield ix (1974). And in Rawlsian terms, "each person possesses an inviolability founded on justice that even the welfare of society as a whole cannot override." see John Rawls, A Theory of Justice, Harvard University Press 3 (1971).
moral capacity of every individual implies the egalitarianism of democratic liberalism, wherein the legitimate authority of the state is dependent on the consent of the individual members of society. Individuals must know what they want and must be capable of making moral choices that reflect their sense of the good. The state is neutral with respect to the good. Citizens, through autonomous democratic choice, determine the goals for the society.

However, Chinese culture does not share the background assumptions — the religious and philosophical soil — from which the notion of rights as trumps arises. The western notion grew out of an individualistic tradition; a tradition that emphasizes the value, indeed the sanctity, of human life. Most Chinese, even if religious, do not share this belief. Daoism interprets life and death as equally part of the great transformation, part of the dao. Similarly, the ultimate goal of Buddhism is escape from the wheel of suffering and rebirth, not preservation of life on earth. For the most part, the traditional Chinese attitude toward human life has been more secular and instrumental than in the West, explaining in part the absence of the kind of heated debate about abortion that exists elsewhere, the wide support for capital punishment, and to some extent the phenomenon of female infanticide.

75 See e.g., Bruce Ackerman, Social Justice in the Liberal State, Yale University Press 10-11 (1980) ("A power structure is illegitimate if it can be justified only through a conversation in which some person or group must assert that he is or they are the privileged moral authority.")

76 Burton Watson, Introduction to Chuang Tzu, Basic Writings 6 (Burton Watson trans., 1964).

Philosophically, although Chinese political thought includes a conception of a quasi-state of nature, it includes no correlative theory of social contract. This is in part because of the lower value assigned to autonomous choice, but also because Chinese theorists do not presuppose rights-bearing, atomistic individuals. The predominant Chinese conception of self is the social self. One is born into a particular social network of family, neighborhood, and state. To conceive of humans apart from the civilizing practices of society is impossible -- one would be not a person, but a beast. Doing what the society and state suppose to be right was more important than the capacity to choose. The central normative issue is not the Socratic inquiry into how the individual

77 Both Xunzi and Mozi propose such stories. See Hsun Tzu, Basic Writings 89-111 (Burton Watson trans., 1963). ("Xunzi" and "Hsun Tzu", and "Mozi" and "Mo Tzu" are variant transliterations of the same Chinese names.) For Mozi, the problem is not that individuals are psychological egoists pursuing their own selfish desires but that each person has a different ethical code. To unify the ethical codes requires a good and wise sage. The response is authoritarian, not democratic. Xunzi, on the other hand, does see the problem as unlimited desires chasing limited resources. The solution to this coordination problem, he maintains, is the hierarchical system of li created and implemented by wise sages. As with Confucianism, the solution is order imposed from above by moral elites. Significantly, neither one suggests that the consent of the people is required, that individuals have rights, or that individuals exist apart from and precede the state.

However, there were moral realists in China who posited that one would directly apprehend the moral way (dao), but they did not attribute a rational faculty to individuals or claim that one could reason one's way to moral truth. In fact, reasons and rational thinking often got in the way. In the Huang-Lao school for instance, one was encouraged to become empty (xu) and still (jing)--eliminating thoughts, feelings, and other biasing factors. Only then could one apprehend the way. If someone challenged another's claim to having discovered the way, one could describe the way and the experience, but one could not produce a rational argument to support this way rather than some moral alternative. See Randall P. Peerenboom, Law and Morality in Ancient China: The Silk Manuscripts of Hung-Lao, State University of New York 70-73 (1993). Even if reason were important in the moral process, as it was for the Mohists, it was a means to figuring out the correct way; it was not valuable in and of itself. Accordingly, no moral value was given to the act of choosing, just to the choice, the results.


79 See Chad Hansen, A Daoist Theory of Chinese Thought, Oxford University Press 3-4 (1992). Hasen argues that Chinese philosophers not only lacked the Kantian moral psychology, but that they shared a naturalist theory of the mind and a pragmatic theory of language, rather than a picture theory of mind...
should live, but instead how the state should be ordered. In this sense, most Chinese ethical thinking has been decidedly elitist. What is right has been determined by moral elites—the sage, the ruler, and now the Party. The moral elite then sought to realize their ethical vision through persuasion or through coercion, or both. The people have been expected to follow. As a result, legitimacy in China has not been based on popular sovereignty derived from the people. Rather, governments claim legitimacy based on their ability to serve the (welfare) interests of the people— or what the rulers determine the people’s interests to be. Thus, government’s interests are the interests of the people,

Language is a social practice. Its basic function is guiding action. The smallest units of guiding disclosure are ming [names]. We string ming together in progressively larger units. The salient compositional structure is a dao [guiding discourse]. The Chinese counterpart of interpretation is not an account of truth conditions. Rather, to interpret a dao is to perform it. The interpretation of a dao starts from the interpretation of the ming that compose it. In learning a conventional name, you learn the socially shared way of making discriminations in guiding your action according to dao.

Id. at 3-4. The role of the sage-ruler was to choose the correct set of names, the correct normative social guidance program (dao), and to model it for others to follow. The idea was that by rectifying names (zheng ming) and modeling correct understanding of the names, one could train the members of society to follow the moral way. Confucius, The Analects XIII:3. Significantly, doing what is right—following the way—is the goal, not moral choice. The moral psychology of choice is absent. The model of mind is behavioristic: the prescriptive dao conditions our experiences and response. We divide the world up in a certain way, and when we confront a particular situation, we respond accordingly based on the programmed dao.

It is interesting to speculate on the continuing influence of this model in light of the emphasis in contemporary China on political meetings in which the latest party line is memorized verbatim (university students take political examinations in which they are presented with long passages and required to fill in the gap with the exact word from the official statement), and on the constant propaganda campaigns with their model citizens [Lei Feng] and slogans (such as the modern campaigns for the four cardinal principles, the five discussions and the four beauties).

Arguably, a few philosophers, Zhuangzi and Yang Zhu among, were more interested in the individual than the socio-political question. See, e.g., Hansen, supra note 79, at 155, 296. Yet neither suggested that individual choice was the essence of humanity or morality.
there can be no conflict. Further, there is no need for the government to hold elections to determine the interests of the people or to obtain their consent since the people's will and the government (Party)'s decisions are coterminous. 82 It is clear that translating rights into the language of interests generally produces outcomes favoring state action and impinging upon individual protections. 83

The Chinese leaders, therefore, do not recognize both the legitimacy of interest groups among the population and the "right" of the populace to press the government and Party with their demands. Rather, they feel that the officials themselves --often, it seems, at the highest levels-- must identify the problems to be given formal recognition and, depending on the nature of the problem, be either managed or solved. The leaders then create or assign an organization to deal with the issue they have identified. In theory, then, the tasks of Chinese bureaucracies are defined not in terms of a particular social or economic group which they represented but rather in terms of the problems and issues that prompt their creation and justify their continued existence. 84

82 Chinese constitutions assumed a harmony of interests between state and citizen. They did not encourage or even recognize the possibility of conflict between the two. For them the purpose of citizen participation was to mobilize popular energies to serve the state. What served the state's interests served the citizen's. Although means were provided for the citizen to appeal against the acts of individual bureaucrats, no avenue was open in any Chinese constitution for the citizen to defend private interests against laws and policies of the state that might damage them. See Andrew Nathan, Chinese Democracy, Knopf: Distributed by Random House (1985), at 123.


As a result, China never developed a real political economy in the sense of openly
acknowledging that political power might be harnessed to advance economic interests.
Those with interests that might be affected by governmental policies could not publicly
call for allies or seek to mobilize opinion in favor of their interests. They could instead
only try to operate quietly by seeking special favors in the implementation of policies,
and thus risk being seen as a source of corruption.\textsuperscript{85} When the leaders identify the
problems in the process of implementation, they would usually tighten the state’s
penetration of local government’s affairs and the private rights of citizen. Thus, the
rhythm of economic regulation in China is not the pendulum swings of left and right, of
change versus continuity as it happens in the US; rather, it follows the up-and-down
motions of centralizing which stifles local initiative, and decentralizing which produces
chaos and detracts from pursuit of the national interest. The US-type pendulum and
China-type pendulum will be further studied respectively in Chapter Two and Chapter
Three in the context of securities regulation.

\textsuperscript{85} For details, see Lucian W. Pye, The Spirit of Chinese Politics, Harvard University Press (1992), at
245. See also Harold D. Lasswell & Abraham Kaplan, Power and Society: A Framework for Political
Inquiry, New Haven Yale University Press (1950), at 74-75. They argue that by conformity to or
disregard of the policy, those whose acts are affected help determine whether it is or os not in fact a
decision.
Chapter II The "Right-and-Left" of Securities Regulation in the United States

In the US, the need to regulate the market and the form that regulation should take, have been the subject of controversy. Market failure, in its exaggerated form, (exemplified by the boom/bust cycle of securities markets) is seen as a symptom of market imperfection requiring regulatory intervention. The controversy has centered upon the form of regulatory intervention and to whom regulatory intervention should be entrusted, to alleviate these imperfections.

The way in which markets are regulated, to protect the investor from fraud and to provide for market stability and confidence, can take many forms. Regulation by government requires the identification of market imperfection and the enactment of laws, to address or alleviate the perceived imperfection. These laws are often accompanied by the full weight of sanctions for noncompliance. Self regulation involves the participants


87 For an interesting discussion of the failure of regulation to alleviate market imperfections see Campbell D, "Why Regulate the Modern Corporation? The Failure of Market Failure", in Corporate Control and Accountability, McCahery, Picciotto and Scott, ed. Clarendon Press Oxford 1993 p.103.
in the market regulating the conduct of participants, and strives for acceptance ( by the participants ), of rules conceived as in the best interests of the participants.

A. Governmental Regulation

There are three distinct types of regulatory devices by government: (1) anti-fraud provisions; (2) provisions requiring the registration or licensing of certain persons engaging in the securities business; and (3) provisions requiring the registration or licensing of securities.

Each of the three regulatory devices represents a somewhat different philosophical approach toward the same end of protecting the investing public. Antifraud provisions are intended to enable the administrator to issue public warnings, to investigate suspected fraudulent activities, to take injunctive or other steps to stop them, and as a last resort to punish them. Registration of brokers, dealers, agents and investment advisers is intended to prevent fraudulent or unqualified persons from entering the securities business, to supervise their activities once registration has been achieved, and to remove them from registration if they fall below any of the statutory standards. Registration of securities is intended to give the investor “a run for his money” by excluding from those securities which do not satisfy the statutory standards.
Although the three regulatory devices might have developed in a mutually exclusively way, they have instead been used to support each other. Everywhere at least two of the devices, and most commonly all three, are combined in the same act. 88

The registration system especially that of securities, however, vary in complexity from state to state. In one type of acts, securities must be registered under a ‘notice of intention” procedure and considerably more information is required to be filed by registered dealers with respect to the securities they sell. That is to say, sales may begin immediately upon filing unless a proceeding is instituted by the administrator. 89 Other types of acts have some sort of registration or permit system for securities whereby authority to sell is conditioned upon affirmative administrative action. The registration system, therefore, may be subdivided as well into disclosure regulation and merit regulation according to the extent of strictness. I proceed now to a somewhat more consideration of the disclosure and merit regulation plus the antifraud regulation.

1. Antifraud Regulation

88 For example, in US three states (Alaska, Maryland and New Jersey) combine fraud provisions with registration of broker-dealers. The other forty-five states have some form of securities registration, or at least some requirement that data be filed by broker-dealers regarding the securities they sell. All but seven of these states also have fraud provisions of one kind or another. Moreover, every one of them except Wyoming also requires the registration of broker-dealers, and that state requires the registration of agents of issuing corporations. See Louis Loss, Securities Regulation, second edition, Little, Brown and Company (1961), Vol. I, at 34.

89 Maine, New Hampshire, Pennsylvania, Massachusetts and Rhode Island belong to this type. See Loss, supra note 10, at 43-49.
In western countries like US, the justification for securities laws must rest upon the degree of protection which they afford to the investing public. Every statute contains provisions which are preventive rather than remedial. The simplest type of preventive provision, and within certain limits the most effective, is that which applies irrespective of any registration or licensing scheme. They apply universally to securities which are otherwise exempted and in most cases to transactions which are otherwise exempted.

The anti-fraud regulation is often supported by those who prefer Adam Smith’s invisible hand to the heavy regulatory hand of the federal securities laws. The necessity of mandatory disclosure rules has been questioned in light of the natural incentives managers have to disclose information. Professor Easterbrook & Fischel argued that:

The firm that disclose more can sell its stock for more, indeed for as much more as the full value of all information. The process works for bad news as well as for good. Once the firm starts disclosing it can not stop short of making any critical revelation, because investors always assume the worst. It must disclose the bad with the good, lest investors assume that the bad is even worse than it is. And the firm cannot stand on its say-so alone. Mere disclosure would be enough if the rule against fraud were perfectly enforced, but it is not. Thus the firm uses . . . verification and certification devices . . . Given these devices, a rule compelling disclosure seems redundant, and if the fraud-penalty and verification devices do not work, a rule compelling disclosure is not apt to be enforceable either.

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90 This was through 1960 the philosophy in New Jersey, and still is essentially in New York. See Loss, supra note 10, at 35-43.


In their view, the anti-fraud provisions can be viewed as requiring firms to provide disclosure warranties to investors, where presumably the legal liability is sufficient to offset the incentives of management to suppress unfavorable information. The argument for governmental intervention as opposed to private sector contracting would be that the SEC has a comparative (cost) advantage in achieving the same result. However, while this argument forms a basis for anti-fraud statutes, it is not clear why a mandated disclosure system is desirable. In other words, why is reliance upon anti-fraud statutes deemed to be inadequate?

The theory of self-induced disclosures, now popular among theorists of the firm and relied upon by Professors Easterbrook and Fischel, however, has only a limited validity. A particular flaw in this theory is that it overlooks the significance of corporate control transactions and assumes much too facilely that manager and shareholder interests can be perfectly aligned. In fact, the very preconditions specified by these theorists as being necessary for an effective voluntary disclosure system do not seem to be satisfied. Although management can be induced through incentive contracting devices to identify its self-interest with the maximization of share value, it will still have an interest in acquiring the shareholders' ownership at a discounted price, at least so long as it can engage in insider trading or leveraged buyouts. Because the incentives for both seem likely to remain strong, instances will arise in which management can profit by giving a false signal to the market.
Antifraud provisions operate by means of investigation, injunction and prosecution independently of any registration system, and typically there are no exemptions from their coverage. New York's Martin Act of 1921 is commonly referred to as a fraud act and it falls primarily in that category. The basic provision, Section 352, is a grant of investigatory power to the Attorney General.

The Attorney General or its representative may subpoena witness, examine them under oath before himself or a magistrate or court of record, and require the production of books and papers. Failure to obey a subpoena "without reasonable cause" is a misdemeanor. When the Attorney General believes "from evidence satisfactory to

93 See Loss, supra note10, at 35-43.

94 The section has a majestic, one-sentence sweep: Whenever it appears to the Attorney General that, in connection with any security (or commodity) or investment advice, any person shall have employed, or employs, or is about to employ any device, scheme or artifice to defraud or for obtaining money or property by means of any false pretense, representation or promise, * * * shall have made, makes or attempts to make within or from this state fictitious or pretended purchases or sales of securities or commodities or * * * shall have employed, or employs, or is about to employ, any deception, misrepresentation, concealment, suppression, fraud, false pretense or false promise, or shall have engaged in or engages in or is about to engage in any practice or transaction or course of business relating to the purchase, exchange, investment advice or sale of securities or commodities which is fraudulent or in violation of law and which has operated or which would operate as a fraud upon the purchase, * * * any one or all of which devices, schemes, artifices, fictitious or pretended purchases or sales of securities or commodities, deceptions, misrepresentations, concealments, suppressions, frauds, false pretenses, false promises, practices, transactions and courses of business are hereby declared to be and are hereinafter referred to as a fraudulent practice or fraudulent practice [,] or he believes it to be in the public interest that an investigation be made, he may in his discretion either require or permit such person * * * to file with him a statement in writing under oath or otherwise as to all the facts and circumstances concerning the subject matter which he believes it is to the public interest to investigate * * *. The attorney-general may also require such data and information as he may deem relevant and may make such special and independent investigations as he may deem necessary in connection with the matter.

95 Section 352.2, 352.3; see also Section 354-56.

96 Section 352.4.
him” that any person “has engaged in, is engaged in or is about to engage in any fraudulent practices,” or (under a 1958 amendment) whenever he shows a conviction anywhere of a crime involving securities or of any felony, he may bring an action in the name of the People against any person participating in any such practices to enjoin their continuation, and he may include an application to enjoin the defendant permanently from selling any securities in any capacity within the state. Refusal to testify or produce relevant papers in an investigation is prima facie proof of “fraudulent practices” so as to sustain a permanent injunction. Violation of an injunction, in addition to being contempt of court and a misdemeanor, may result in a civil penalty of $3000. On the criminal side, violation of any of the provisions of the Martin Act is a misdemeanor. The commission of “fraudulent practices” under the basic Section 352 is per se criminal. That is to say, Section 352 is not merely a basis for investigation and injunction, such practices are prohibited by that section. The machinery of investigation and injunction in other antifraud jurisdictions is much the same as in New York.

2. Disclosure Regulation

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97 Section 353.1.
98 Section 353.1
99 Section 359-g(1).
100 Section 359-g(2)
People in favor of the mandatory disclosure addressed in a different way the problems of the information asymmetries between investors and managers, in which the managers know the position and performance of the firm and outside investors do not. First, they argue that the disclosure regulation exists because of the unique informational needs of investors. Unlike cars and other tangible products, securities are not inherently valuable. Their worth comes only from the claims they entitle their owner to make upon the assets and earnings of the issuer, or the voting power that accompanies such claims. Deciding whether to buy or sell a security thus requires reliable information about such matters as the issuer's financial condition, products and markets, management, and competitive and regulatory climate. With this data, investors can attempt a reasonable estimate of the present value of the bundle of rights that ownership confers. Second, information has many characteristics of a public good, securities research tends to be underprovided. This underprovision means both that information provided by corporate issuers will not be optimally verified and that insufficient efforts will be made to search for material information from non-issuer sources. A mandatory disclosure system can thus be seen as a desirable cost reduction strategy through which society, in effect, subsidizes search costs to secure both a greater quantity of information and a better testing of its accuracy. Although the end result of such increased efforts may not significantly affect the balance of advantage between buyers and sellers, or even


the more general goal of distributive fairness, it does improve the allocative efficiency of
the capital market—and this improvement in turn implies a more productive economy.
Third, a substantial basis exists for believing that greater inefficiency would exist without
a mandatory disclosure system because excess social costs would be incurred by
investors pursuing trading gains. Collectivization minimizes the social waste that would
otherwise result from the misallocation of economic resources to this pursuit.103 Fourth,
even in an efficient capital market, there remains information that the rational investor
needs to optimize his securities portfolio. Such information seems best provided through
a mandatory disclosure system.104

In United States, the mandatory disclosure system mainly comprises the
disclosure for public offerings and continuous disclosure. Through the preparation of a
registration statement, the Securities Act of 1933 seeks to assure full and fair disclosure
in connection with the public distribution of securities. The objective of the process is
the prospectus. The prospectus is designed to provide all material information necessary
for investors to fully assess the merits of their purchase of the security, the prospectus is
the vehicle for stationing investors on as nearly an equal footing with the issuers and
their underwriters as possible, with the hope their purchase is neither worthless nor
overpriced. Whereas the Securities Act grapples with the protection of investors in
primary distributions of securities, the Securities Exchange Act of 1934’s concern is

103 Id.
104 Id.
trading markets and their participants. An important contribution to efficient trading markets is the '34 Act's system of continuous disclosure for companies required to register under its provisions. The most significant of the compelled reports is the annual report on Form 10-K and quarterly reports on Form 10-Q. A further report compelled by Section 13 is Form 8-K, which must be filed within 5 to 15 days of the occurrence of a material development of the type specified in the form.

The disclosure regulation did not spring full grown from the brow of any New Deal Zeus. It followed several centuries of legislation in England and a generation of state regulation.\(^\text{105}\) For the problems at which disclosure regulation is directed are as old as the cupidity of sellers and the gullibility of buyers.\(^\text{106}\) The Companies Act of 1900 in England had followed the report of the Lord Davey Committee of 1985, which is notable for its expression of the disclosure philosophy that marks both the English Companies Act and the American Securities Act to this day.\(^\text{107}\)

\[\text{** * * * ** \text{it must be generally acknowledged that a person who is invited to subscribe to a new undertaking has practically no opportunities of making any independent inquiry before coming to a decision. Indeed, the time usually allowed between the issue of the prospectus and the making of an application does not permit of any real investigation.}}\]

\(^{105}\) For a discussion of the history, see Loss Securities Regulation.

\(^{106}\) Id.

\(^{107}\) The man who left the greatest mark on the philosophy of federal securities regulation in the United States, however, was Louis D. Brandeis. In Other People's money, published in 1914, he had strongly urged publicity as a remedy for social and industrial diseases generally, and excessive underwriters' charges specifically. "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." See Loss, supra note 10, at 123.
The maxim of Caveat Emptor has in the opinion of your Committee but a limited application in such cases.

It is therefore of the highest importance that the prospectus upon which the public are invited to subscribe shall not only not contain any misrepresentation but shall satisfy a high standard of good faith. It may be a counsel of perfection and impossible of attainment to say that a prospectus shall disclose everything which could reasonably influence the mind of an investor of average prudence. But this in the opinion of your Committee is the ideal to be aimed at, and for this purpose to secure the utmost publicity is the end to which new legislation on the formation of companies should be directed.\textsuperscript{108}

The federal securities legislation of the United States is essentially a combination of the disclosure theory of the English Companies Act and the fraud theory of the New York Martin Act, with important modifications. It was aptly termed "the truth-in-securities act." Congress did not take away from the citizen 'his inalienable right to make a fool of himself."\textsuperscript{109} It simply attempted to prevent others from making a fool of him.

3. Merit Regulation

In United States, merit regulation is a regulatory system that allows state [securities] administrators to deny registration to a securities offering unless the substantive terms of the offering and the associated transactions (1) ensure a fair relation

\textsuperscript{108} Cmd.7779 (1895) Section 5, 6.

\textsuperscript{109} The language is from the 1935 Report of the [Canadian] Royal Commission on Price Spreads (p.38), although the recommendations of that commission came closer to the qualification than the disclosure philosophy.
between promoters and public investors, and (2) provide public investors with a
reasonable relation of risk to return. While merit and disclosure regulation should not be
regarded as antitheses, merit regulation differs from disclosure regulation in its direct
regulation of the internal structure of a securities issuer, of the relations among insiders
and outsiders, and of the terms of the offering.\footnote{American Bar Ass’n Ad Hoc Subcomm. on Merit Regulation, State Regulation of Securities Comm., Report on State Merit Regulation of Securities Offerings, 41 Bus. Law. 785, 829 (1986). The literature on merit regulation is extensive. See ABA Report, supra, at 785; see also Mark A. Sargent, State Disclosure Regulation and the Allocation of Regulatory Responsibilities, 46 Md. L. Rev. 1027, 1037-47 (1987).} For more than a generation—between
1911 and 1933—securities sales in the United States were regulated nearly exclusively by
the specialized state statutes known colloquially as ‘blue sky’ law\footnote{The derivation of the term ‘blue sky law’ is a matter of considerable uncertainty. The most plausible explanation in the literature, advanced by a careful and informed student of blue sky laws, is that the term referred to the fact that the fly-by-night operators in Kansas operated so blatantly that they would ‘sell building lots in the blue sky in fee simple.’ Tomas Mulvey, Blue Sky Law, 36 Can. L. Times 37, 37 (1916).} and merit regulation
is the most distinctive and best-known aspect of blue sky law.\footnote{Blue sky law includes much more than merit regulation and much more than the regulation of securities offerings in general. Merit regulation is famous because it is so controversial and so different from SEC-type disclosure regulation and because it has been a part of blue sky law since the beginning.} This regulatory
technique reached its apogee in the late 1970s and early 1980s when state administrators
extended an ever more elaborate web of merit requirements not only over corporate
equity offerings, but also over the burgeoning number of limited partnership offerings or
Blue sky law carries its concern with investor protection to greater lengths than the disclosure mechanisms of the federal securities laws. It attempts to protect the investor from himself. The 1933 Act tries to protect investors by mandating disclosure of the information that investors need to make an informed decision. The merit statutes try to protect them by defining which offerings are so substantively flawed that they should not be presented to investors at all.\textsuperscript{114} The statutes thus permit regulators to take the investment decision out of the hands of investors.\textsuperscript{115}

With respect to merit discretion there is reason to be skeptical about the benefit it provides to investors. A former Commissioner stated that:

The practical difficulty of course, is that if the [Commission] were to attempt to pass judgment in detail on the viability of the new enterprise, [it] would have to have at [its] disposal a staggering number of highly sophisticated experts from various disciplines. The result would be an economy heavily subject to public regulation, to a much greater extent than Canadians have been accustomed.\textsuperscript{116}

\textsuperscript{114} There is reason to be skeptical about the benefit it provides to investors. see D. Johnston, Canadian Securities Regulation, Toronto: Butterworths 160 (1977); R. Brealey & S. Myers, Principles of Corporate Finance, Toronto: McGraw-Hill Ryerson 301 n. 6 (2d ed. 1984).

\textsuperscript{115} The classic statement is that of J.N. Dolley, the father of blue sky regulation, who remarked: “It has been said that the people do not need a guardian tp supervise their investments, but I want to say to you that a large [percent] of them do need a guardian, especially in matters of this kind.” The president of the Florida Bankers’ Association was even more explicit, recommending Kansas-style legislation on the ground that “we should have some legislation in this state to protect the public against its own weakness. I refer to the means by which the public is tempted by the prospect of quickly acquired wealth, to part with its money in exchange for securities that are steeped in fraud.” George W. Allen, Florida Banking Resources Increase, 78 Am. Banker 1322 (1913).

Even if substantial blue sky screening were provided by securities commissions, it is by no means clear that public investors would thereby be made better off. If the effect of the screening is to foreclose investments in speculative firms, established firms would be protected from competition. In addition, public investors would be prevented from purchasing shares in successful as well as unsuccessful ventures. One example of this was the decision of the Massachusetts securities commission in December 1980 barring the first offering of securities in Apple Computer Inc.

The blue sky laws, however, appear to have been formed and adopted through a process of interest group rivalry not significantly different from the process observed in many other legislative contexts. According to professors Macey and Miller, contrary to the standard explanation, the blue sky laws were not necessarily "a public-spirited, spontaneous populist response to serious abuses in securities markets." Among the principal determinants of the spate of statutes between 1911 and 1913 was the rivalry

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117 The capture theory of regulation would predict this result. In the regulatory context, decision-makers can be expected to favor those groups that can benefit them the most. Many times, however, many of the people who will be affected by a regulatory decision will not be represented by any group. In those circumstances, a phenomenon called "agency capture" could occur. An agency is captured when it favors the concerns of the industry it regulates, which is well-represented by its trade groups and lawyers, over the interests of the general public, which is often unpresented. See Peltzman, Toward A General Theory of Regulation, 19 J. Law & Econ. at 212; Posner, Theories of Economic Regulation, 5 Bell J. Econ. & Management Sci. 341-43 (1974).


119 See Macey & Miller, supra note 16.

120 Id. at 396.
between the political coalition favoring merit regulation, which included smaller banks, state banking commissioners, and local borrowers, and the coalition opposing such legislation, which included the elite investment houses, the large banks, and bond issuers such as major manufacturing firms, railroads, and public utilities.\(^\text{121}\) By and large, the early stringent blue sky statutes were adopted in agricultural states without a significant presence of large banks, investment houses, or major manufacturing firms. \(^\text{122}\) States with important securities houses or significant manufacturing interests, as well as states competing to attract corporations to charter within their borders, did not adopt stringent blue sky laws.\(^\text{123}\)

\(^{121}\) Between 1911-1913, economic conditions—a sustained period of inflation and high nominal interest rates—threatened the ability of small banks and savings institutions to attract or retain consumer deposits in competition with higher yielding securities and restricted the supply of credit to local borrowers. This threat gave both small banks and local borrowers an interest in suppressing the activities of out-of-state securities firms. See Macey & Miller, supra note 16, at 420.

\(^{122}\) Kansas in 1911 enacted the first comprehensive system of registering securities brokers and offerings of securities of all types of enterprises. The most enduring contribution of Kansas model to securities regulation is the preoccupation of blue sky laws with assessing the offering’s fairness. Arizona and Vermont adopted blue sky legislation patterned on the Kansas model in 1912. State regulatory activity accelerated through 1913. Eight states adopted legislation closely patterned on the Kansas model, granting a designated agency the power to reject proposed issues which did not offer a fair return on a buyer’s investment: Arkansas, Idaho, Michigan, Montana, North Dakota, South Dakota, Tennessee and West Virginia. The Province of Manitoba enacted the Kansas blue sky law almost verbatim in 1912. Ohio enacted a statute which, while not directly patterned on the Kansas model, permitted the relevant state authority to reject a security if the issuer’s “proposed disposal of its securities is on unfair terms.” See Macey & Miller, supra note 16, at 423.

\(^{123}\) See Macey & Miller, supra note 16, at 431. Securities regulation laws made no headway in states such as Nevada, Maryland and Delaware which were active participants in the corporate chartering market. Maine, another competitor for corporate charters, adopted a modified disclosure regulation patterned generally on legislation recommended by the Investment Bankers Association (IBA), which required registration of securities dealers and imposed penalties for fraudulent statements about securities or dealers.

The Indiana legislature approved a blue sky statute only to see it vetoed by the governor after intense lobbying by a coalition of investment bankers and manufactures. Blue sky legislation was also vetoed in Colorado. Illinois and Pennsylvania—states with active securities industries and large manufacturing firms—rejected proposals for Kansas-style statutes. A blue sky law was also proposed, and apparently defeated, in Minnesota.
A regulated industry may support a particular regulatory regime if the regime legitimates the industry, helps it solve its competitive problems by imposing barriers to entry, or forestalls more radical government intervention. None of these motivations, however, have affected the securities industry's attitude toward blue sky law, which usually has been hostile. As a result of the tension between the major market participants and the state administrators, questions about the philosophical soundness, Other states, while adopting securities regulation statutes, rejected essential features of the Kansas model. Missouri and Florida adopted legislation modeled on the Kansas statute, but omitting the crucial power to reject a sale of securities if the offering did not promise a fair return on the investment. Other jurisdictions requiring registration and disclosure and prohibiting fraud, but not permitting the exclusion of securities solely because they were bad investments, were Georgia, Iowa, Nebraska, North Carolina, Oregon, Texas and Wisconsin. California adopted a statute which applied only to initial securities offerings, not secondary trading, and which permitted securities brokers to obtain a general exemption to sell securities of any sort upon proof of good reputation.

In Massachusetts—a state with a significant population of issuing firms and the location of a leading regional securities exchange—a legislative commission noted that securities sales in Massachusetts were usually made through bankers and brokers in the state and "no complaints had been presented as to their operations." The commission recommended a version of the IBA's proposed statute without merit regulation. Such a statute was introduced in the Massachusetts legislature in 1913. In New York a fierce battle broke out between those favoring Kansas-style legislation—presumably agrarian and upstate interests—and the securities industry and stock exchanges. The state assembly adopted a Kansas-style bill in 1913, but the IBA organized to kill the bill in the state senate.


usefulness, practicability and political legitimacy of merit regulation have been a constant throughout its eighty-plus years of existence.\(^{126}\) There is no need at this point to add to that debate since in the last decade, major changes advanced by the market participants have substantially reduced the impact of merit regulation, rendering it, if not largely irrelevant, at least accidental in its potential applicability. Most larger offerings escape merit review by means of a marketplace exemption.\(^{127}\) Small and some medium-size offerings often avoid it by qualifying for ULOE-based exemptions.\(^{128}\) Other offerings miss its full impact by qualifying under “presumptive merit” or other special rules.\(^{129}\)

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\(^{126}\) For a discussion of this history, see Louis Loss & Joel Seligman, supra note 10.

\(^{127}\) The marketplace exemption is a complete exemption from state registration for all securities of an issuer listed (or approved for listing upon notice of issuance) on the New York or American Stock Exchanges or the National Association of Securities Dealers Automated Quotation/National Market System (NASDAQ/NMS). The net result is that any issuer that can qualify for listing with one or more of those organizations will probably do so, in part to avoid the costs, delays, and substantive problems created by state registration requirements. See Mark A. Sargent, A Future of Blue Sky Law, University of Cincinnati Law Review, Vol.62, at 451.

\(^{128}\) Most states have adopted coordinating rules that allow limited and private offerings exempted under federal Regulation D to be exempted at the state level and hence to escape state registration and the application of merit standards. And most of these coordinating rules are modeled after the Uniform Limited Offering Exemption (ULOE), a uniform rule adopted by NASAA in 1983. See Sargent, supra note 127, at 451.

\(^{129}\) Illinois and Louisiana, for example, amended their blue sky statutes to eliminate all authority to deny registration to securities offerings on substantive grounds. Administrators in yet other jurisdictions, fearful of legislative challenges to their merit authority, tried to head off such challenges by adopting rules defining offerings that will be deemed to have satisfied the state’s merit requirements without having undergone a thorough review of compliance with all or some of the state’s merit standards. These provisions are usually called “presumptive merit,” “fast track,” or “merit safe harbor” rules. A different type of approach limited the reach of merit regulation in Wisconsin, previously one of the leading merit jurisdictions. Its statute provides that if a registered offering is made only to a certain class of investors, then the offering will not be subject to full-scale merit review. Some states also are softening the application of merit authority to offerings under one million dollars that are registered on Form U-7, the so-called “Small Corporate Offerings Registration” (SCOR) form adopted or about to be adopted by about thirty states. See Sargent, supra note 127, at 453-55.
The almost accidental character of merit regulation today means that the regulatory philosophy has shrunk radically in significance. It also means that its legitimacy has been seriously compromised. How can one defend a situation in which only a relatively narrow class of offerings remain subject to such stringent substantive regulation, when so many other offerings of a similar character escape it altogether? It is hard to see how its supporters can resolve this crisis, even if the deregulatory sentiments prevalent in the last decade are transformed or muted by greater support for financial regulation as a response to that decade's apparent excesses. Merit regulation is not likely to be a beneficiary of any such new sentiment for more stringent securities regulation. The securities market scandals of the 1980s--including the uproar over abuses in the penny stock market--has not produced a new enthusiasm for revived or expanded merit regulation that could overcome industry resistance and wide-spread skepticism about the merits of merit regulation. The regulatory philosophy survives, but the focus of blue sky regulation is gradually and inexorably shifting to its other segments, such as antifraud enforcement.130

B. Self Regulation

Self regulatory schemes in developed markets range from the US institutional model where categories of market participants are defined and the duties which each

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130 For more discussion, see Mark A. Sargent, supra note 127, at 471.
type of participants must undertake are specified,\textsuperscript{131} to the UK functional model where
the activities in need of supervision are identified and regulation for each of these
activities is specified.\textsuperscript{132} No matter which model is adopted, self regulation has the
following advantages: the operations of the market are regulated by those who are the
most knowledgeable and up to date on the matters being regulated; it possesses the
overall flexibility and adaptability which means that the system can keep up to date with
market conditions; it is sometimes said to be cheaper than a complete scheme of
statutory regulation. The main problem with self regulation is that it can allow conflicts
of interest to arise, such as when an exchange which is owned by its members regulates
these members. It has been said that various self regulatory organizations both in the US

\textsuperscript{131} Section 5 of Securities Exchange Act of 1934 requires all exchanges to register as 'national securities
exchanges.' There are ten registered exchanges: The two truly national exchanges are the New York
Stock Exchange and the American Stock Exchange and the others are smaller regional exchanges. In
addition to registering, a national securities exchange must satisfy the requirements in Section 6, which
requires just and adequate rules to ensure fair dealing and to protect investors.

The securities industry and SEC joined forces in 1938 to secure the amendment of the Exchange Act to
embrace in Section 15A a "national securities association" whose task is to prevent fraudulent and
manipulative acts and to promote just and equitable trade practices among over-the-counter broker-
dealers. The only such association is the NASD, to which most brokers belong. The NASD is the
largest of the SROs, with an extensive staff and 14 district offices. The NASD's scope of responsibility
is broad and includes overseeing the operation of the over-the-counter market and establishing and
enforcing rules for its efficient and fair operation.

The third type of SRO is that for clearing agencies and transfer agents. Congress added Section 17A to
the Exchange Act calling for registered clearing agencies and establishing minimum standards for the
governance and powers over members. The largest of these organizations is the National Securities
Clearing Corporation, a company formed by the joiner of three subsidiaries of the NYSE, Amex, and
NASD.

The final type of SRO is the Municipal Securities Rulemaking Board established by the 1975 legislation
adding Section 15B to the Exchange Act. The MSRB is exclusively a rulemaking body concerned with
promoting fair and efficient practices for brokers and dealers who trade in municipal securities.

\textsuperscript{132} See UK Financial Services Act of 1986.
and UK have been “taken over” by the industry which they regulate and which has therefore appointed them to enforce anti-competitive rules.\textsuperscript{133}

Self regulation, to be effective in establishing a balance between the interests of the market participants, the stability and confidence in the market and the protection of investors requires certain conditions to exist in the market. The first condition is a recognition in the market, that it is in the interests of the market to regulate itself. Without an acceptance of self regulation and the codes of conduct by which the activities of the participants is adjudged, self regulation will be ineffective. The city of London model is usually held up as the premier example of self regulation in operation.\textsuperscript{134} Tomasic argues that the success of self regulation in the City of London was made possible by the existence of a “close knit community, bounded together by geographical proximity, tradition, self interest and the culture of the class system, recognizing shared values and imposing acceptable forms of conduct.”\textsuperscript{135} The second condition is the existence of an homogenous set of interests. If homogeneity does not exist, then at least a recognition of all the interests of the market must be established, so that the interests of a few do not dominate the interests of all.\textsuperscript{136} Finally, the operation and implementing of


\textsuperscript{134} The English securities market has been subject to regulation imposed through legislative enactments, in the Financial Services Act 1986.

\textsuperscript{135} Tomasic, Casino Capitalism?, Australian Institute of Criminology, 1991, p 81.

self regulation needs to be monitored, to ensure that it is working effectively to achieve the aims both of the market and the regulation.

Self regulation as it was undertaken in New York (1929 crash), City of London (Big Bang) and Hong Kong (1987 crash), was not successful in implementing either stability or investor protection. It was successful in ensuring that the vested interests of a few took precedence in the market. An analysis of why self regulation failed illustrates that most or all of the factors referred to as necessary for the effective implementation of self regulation, did not exist.

Before governmental intervention, the exchanges were described as “private clubs” for the benefit of the participating members and their associated interests, with scant regard for the interests of the investing public or the concepts of transparency, fairness and openness in the market.137 There was a lack of acceptance or understanding of the role of self regulation, in the mindless pursuit of profit. In the cases of New York and Hong Kong, the competition between local exchanges further precluded the development of cooperation towards the development of industry regulation since the rivalry did not facilitate the development of a homogenous set of values or standards in the market.

The financial crisis in the wake of the 1929 and 1987 world stock market crash, sent most of the major financial markets plummeting. Domestic and international confidence in those securities markets disappeared, over night. These crises exposed the ineffectiveness of the securities regulatory structure. While the structure itself was not responsible for the financial crisis, it was completely ineffective in aiding, equipping or directing the market out of financial turmoil. It was apparent that the deficiencies in the structure and role of the securities regulators were but a symptom of a much greater problem in the general structure and operation of the market.

Nowadays both UK and US describe their systems as self regulation within a statutory framework. Self regulatory status is granted to exchanges and other industry bodies, in the US notably to National Association of Securities Dealers, who are required to set rules which they must then enforce on their members. There are few markets running without any specific securities legislation. The last major exchange to become subject to securities legislation was the London Stock Exchange when in 1986 the Financial Services Act was introduced.

The political compromise inherent in the dual system of governmental regulation and self regulation is an uneasy one. How much deference should the SEC give to organizations that, notwithstanding their statutory designation as quasi-public bodies, are

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138 For an analysis of the threat posed by the stock and futures market crash to the wider economy and why Hong Kong's securities markets were unable to weather the collapse of the market see Gunningham, supra note 136.
still governed by member securities firms with a significant self-interest at stake in any form of regulation? Can the SEC depend on the "enlightened self-interest" of the industry to behave generally in a public-regarding fashion? Or will self-regulation become a method by which the industry "establishment" quashes undue competition or sets undue barriers to entry? On the other hand, is the SEC, by all accounts a lawyer-dominated agency, sufficiently competent to take the primary role in the intricate and technical operations of the market?139

Sensitive to these conflicting interests, the '34 Act has always provided for a certain degree of SEC oversight of SRO activity. In the early days of self-regulation, SEC Chairman William O. Douglas described the creative tension underlying this system in vivid terms: It is one of "letting the exchanges take the leadership, with the Government playing a residual role." However, "government would keep the shotgun, so to speak, behind the door, loaded, well-oiled, cleaned, ready for use but with the hope that it would never have to be used."140 In 1975, Congress clarified and strengthened the SEC's oversight role; under Section 19(b) and (c), the SEC must approve any rule change proposed by the SRO, and may, on its own motion, "abrogate, add to, and delete from" the SRO's rules. The standards to be applied are the same as those for


evaluating whether an SRO should be registered. Similar oversight authority exists under Section 19(d) with respect to SRO disciplinary proceedings. The courts have held that actions taken by the exchanges under this self-regulatory structure, approved (explicitly or implicitly) by the SEC, are given a qualified immunity from antitrust challenge.  

C. The Structure and Mechanisms of Securities Regulation in the US

Any successful securities regulatory regime is dependent on a combination of factors. These factors include effective policy planning, workable legislative and regulatory regimes, adequate government funding and resource support, market recognition of the role of regulation and acceptance of that role. These factors are hinged on the ability of the market regulator to create an environment in which securities regulation is seen as enhancing the securities market and not blanketing it in inefficient and ineffective controls. From the experience of US and UK, we find the success lies in the combination of state regulation and self regulation, the so-called two-tier system. The logic of the two tier system is that it is seen as the most cost-effective way to deliver adequate investor protection, through a senior regulator such as SEC and SIB which

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dedicated to the public interest to set the standard and front-line regulators\textsuperscript{142} to deliver adequate investor protection.

Alternative models were rejected both in US and UK, including the unitary model of a single all-embracing regulator, which was seen as likely to be bureaucratic, less sensitive to market development, and less likely to engender the commitment of the industry. Knowledge and participation by the market appears to be the key to the successful implementation of a workable regulatory regime. Without knowledge, acceptance and participation by the market, regulation will be ineffective in establishing the objectives of the market and enforcement will be futile. Securities markets need to plan for, in a lucid and informative way, the role regulation is to play in achieving of the objectives of the market. Regulation itself is not the market's objective.

As Mann notes in his "What Constitutes Successful Securities Regulatory Regime?"\textsuperscript{143}:

Regulators must constantly remind themselves that it is the markets, and not regulation that reflect the perceived value of securities. It is the market that has expanded globally to respond to the demands of business. And finally, it is the market, and not the regulators, that have developed new instruments to satisfy the desire of investors to hedge the risk.

\textsuperscript{142} In UK, there are SROs, RPBs, RIEs, RCHs. In US, there are NASD, National Securities Exchanges, MSRB, National Securities Clearing Corporation.

With this restraint etched in the mind of the US primary securities regulator, the Securities Exchange Commission (SEC), the regulatory environment is based on a number of inherent rules that are both recognized and accepted by the participating market players. These rules establish the obligations of the players and set a simple and effective philosophy by which the SEC regulates the market. These rules encompass the major premise that the market is established in an honest and fair environment. To this end the obligation of the participants can be stated simply as do not lie, disclose fully and deal fairly.

Securities regulation does not exist in a vacuum. The effectiveness of regulation has to be measurable or quantifiable if it is to be accepted as a necessary part of the securities market. In this analysis the role played by the senior regulator is two fold. First, the role of the regulator in imposing and policing regulation is vital to ensure that regulation is administered and seen to be administered fairly and evenly. Secondly, the ability of the regulator to use its powers to protect the market participants is vital if those participants are to have confidence in the market. Just as President Roosevelt said on March 29, 1933: "The purpose of this legislation I suggest is to protect the public with the least possible interference to honest business."\textsuperscript{144}

No market regulatory regime is perfect. The US regulatory regime, with its long history, public awareness and public and participant’s acceptance, is not without its susceptibility to financial scandals. The SEC has in the last decade been at the center of investigations into securities market scandals including the saving and loans scandal, the BCCI collapse, market rigging and insider dealing exploits involving Michael Milken and Ivan Boesky. This is not to forget the potential developments in the wake of the Orange County bankruptcy, linked to its chief financial officer’s disastrous derivative forays and the losses of Daiwa Bank of Japan (estimated at US$1.1b), from unauthorized trades made by Daiwa employee, Toshide Iguchi, over a period of 11 years, from Daiwa’s New York office. The SEC has increased civil litigation against insider trading in the decade between 1977 and 1987 by three fold.\textsuperscript{145}

Securities regulation is therefore not effective to create the perfect market. What must exist in the wake of this inadequacy is the recognition that the regulator is empowered, armed with the full weight of effective sanctions, to investigate and bring to justice those who breach the fundamental tenets of the system. The existence of the tenets and the understanding by the market of those tenets is therefore vital.

In the US it is not possible for the SEC to monitor and investigate every transaction and foray that occurs in the market. Nor is it able to monitor every action of

\textsuperscript{145} Tomasic, supra note 135, p 32. 137 civil actions in this period had been brought, compared to 48 in the previous 28 years.
the participants in the market. The market in size is enormous. The New York Stock Exchange alone has the highest turnover of all international markets on a daily basis. There are over 8,000 securities firms across the country, not to mention thousands of employees operating in those firms. Then there are all the connected activities in the market and the investors.

The imposition of regulation would be impossible if not for the acceptance by the market players of the principles of regulation and an understanding of the policy directing those principles. Coupled with this acceptance and knowledge, is a regulatory structure that permeates all levels of market involvement. The hallmark of this regulatory structure is disclosure and enforcement.

At the top is the SEC with overall jurisdiction. Underneath are the self-regulatory organizations, all answerable to the SEC, such as the stock exchanges and industry associations. Then follows the dealer firms. In the firms there are requirements of control, supervision and responsibility making, in many cases, the supervisor/employer responsible for the actions of the dealers/employees. Companies listed on the markets are also part of the regulatory process. The legislative requirements of disclosure and enforcement

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146 Almost half of all SEC investigations are mobilized "proactively," they are initiated by SEC staff themselves. Shapiro S, Wayward Capitalist, Yale University Press, New Haven 1984, p 57.

147 id p 80.

148 see the antifraud regulation and disclosure regulation of this Chapter.
independent assessment make this part of the process very effective. Market players, watchers and forecasters acting as market monitors play a role as do other social control agencies such as the police, judiciary and state attorneys general departments.¹⁴⁹

The SEC was able to introduce this disclosure/enforcement strategy at its inception and has been successful in maintaining it to present times. The result is that the market participates openly in this strategy.

In her analysis Khademian suggests that the success of the SEC, in its implementation of the disclosure/enforcement approach aimed at achieving the principles of honesty and fairness in the market, resulted from a combination of factors which hinged on the appointment of Joseph Kennedy as the SEC’s first Chairman,¹⁵⁰ a wily investment banker and market player. Some saw the appointment as tantamount to “letting the wolf into the hen house”. The administration, however, saw that securities reform was inexorably linked to the acceptance of regulation by the market, rather than the imposition of regulation on the market. Appointing Joseph Kennedy as the first Chairman of the SEC, and adopting a cooperative approach towards the securities industry aided the dual efforts of the administration in restoring confidence to the market and promoting acceptable levels of reform. It is apparent that, whatever level of

¹⁴⁹ Mann, supra note 136, p184.

regulation is to be imposed in the securities market, acceptance by the market players is a vital ingredient to its success.\textsuperscript{151}

\textsuperscript{151} There is debate over the ability of the market to regulate where the participants represent diverse and conflicting interests. One side of the argument, the consensus pluralism approach, says that a system of checks and balance and a regulatory policy that reflects all the motivations of the participants will be sufficient to regulate the market. Gunningham challenges that there is no evidence to indicate that such a model is actually operating in the market. He states that without direct government intervention in regulation, there is no inbuilt balancing of interests. Gunningham, supra note 136, p 27.
Chapter Three  The "Up-and-down" of Chinese Securities 

Regulation

China’s regulatory purview has grown sporadically in reaction to events. The regulatory agencies have been very sensitive to the fact that people are making a lot of money, losing a lot of money, or the country’s reputation is being tarnished. All the regulators are in the hot seat. They are trying to get the genie back into the bottle: they are asking themselves how they can control things. The result is that securities regulation in China does not just mean investor protection. The regulatory bodies see their role extending far beyond regulation. They are not there just to set up basic rules and see they are obeyed. They have a variety of other tasks ranging from deciding which companies are suitable for listing to intervening in the market if companies are not performing well. As will be discussed below, events play a very important role to determine the up-and-down of china’s securities regulation.

A. Primitive Experiments Period

The transformation of SOEs into shareholding companies began in the early 1980s when some local governments in a few scattered areas started to take the initiative in an effort to find a solution for the seemingly apathetic state sector. These early experiments were carried out without very much legislative support since the term privatization was still very much taboo for the country’s ideologically correct
theoreticians. Only a few of the more audacious local officials actually promulgated rules to provide guidance for the experiments.\textsuperscript{152} Most other local governments chose to ‘cross the river by feeling the stones on the bottom’\textsuperscript{153} as they went along, leaving no consistent and discernible rules.

Compared to the so-called “standardized” companies, that is, companies formed in the 1990s under the Opinions on Standards for Limited Liability Joint-stock Companies\textsuperscript{154} (the Standards Opinion), these early experimental companies were distinguished by their dispersed stock ownership and small scale. For example, Yanzhong, Feile Audio, and Aishi—the three joint-stock companies incorporated in Shanghai—had total capital of RMB 5 million, RMB 500 thousand, and RMB 300 thousand respectively. The percentage of shares held by individual investors was 94\%, 70\%, and 69\%, respectively. There are respectively 16,000, 500, and 300 individual shareholders of each company. Each shareholder holds shares worth about RMB 250

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\item \textsuperscript{152} Shenyang, Shenzhen and Chengdu are among these localities. In September 1984, the first joint stock company was established under this system (Tianqiao Department Store in Beijing). The introduction of the Joint Stock Company system commenced in Shanghai in 1985 and in Shenzhen in October 1987. See Robert Nottle, The Development of Securities Markets in China in the 1990s, Company Law and Securities Law Journal, December 1993, at 504.
\item \textsuperscript{153} A very popular line usually attributed to Mr. Zhao Ziyang, former General Secretary of the Chinese Communist Party, typically quoted as the policy justification for gradually reforming the system by cautious trial and small error. See Zhao Ziyang, supra note 51.
\item \textsuperscript{154} Gufen youxian gongsi guifan yijian [Opinion on Standards for Companies Limited by Shares] (hereinafter Standards Opinion), reprinted in China’s New Companies Volume I: National Framework at 11 (text is in Chinese and English).
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(face value) on average.\textsuperscript{155} Although few of the measures employed in the early local regulations to regulate and control joint-stock companies have been retained in the current legal framework, these flexible practices provided a relatively forgiving environment that helped to transform struggling, small enterprises into joint-stock companies.\textsuperscript{156}


\textsuperscript{156} Under the old system:


2. The company’s articles of association, and not the law, determined the maximum number of shares held by individuals. See Guide to the Stock System, art. 12.

3. Minimum capital requirements could be as low as RMB 50 thousand to RMB 100 thousand. These amounts were .05% to .10% of the paid in capital of companies listed in 1992. See id. art.9.

4. Shares prescribed in a corporation’s articles of association need not be entirely subscribed and paid-in at the time of corporate registration, but could be issued several times after the incorporation. See id. art. 52.

5. State shares (that is, those held in the name of the state) need not all be common shares, though, conversely, some cities wanted to make the state’s shares preferred. “With regard to the state’s shares in an ordinary share system enterprise, the state’s shares may be preferred ones which are not involved in operational decisions but receive only a fixed amount of return on investment.” \textit{Shanghaishi gufenzhi qiye zanzxing banfa} [Shanghai Municipal Temporary Measures for Share System Enterprises], art. 25 (1988), reprinted in \textit{Gufenzhi de lilun yu shijian} [Theory and Practice of the Share System, part I] 250-55, 260-70 (Chen Jiagu ed. 1988). “The state’s shares are preferred shares; other shares are ordinary shares.” \textit{Sichuansheng Shehuizhuyi Gongyuzhi Qiye Gufen Jingying Zerenzhi Shixing Fangan} [Provisional Plan for Stock Management Responsibility System in Socialist Publicly-owned Enterprises] art. 9 (1986), reprinted in Theory and Practice of the Share System 250-55, 262-70.

6. Capital retained by companies on the basis of law or responsibility contracts (chengbao hetong) could be divided into “enterprise shares” (Qiye gu). These were shares held beneficially by the
Another experiment consisted of establishing securities trading markets. This occurred in 1986 when the people’s Bank of China (PBOC), Shanghai branch, sanctioned the Industrial and Commercial Bank of China to establish an over-the-counter (OTC) market for bonds and shares. The northeastern industrial city of Shenyang set up its own OTC markets in the same year. In 1988, shares in the Shenzhen corporation for its employees. Sichuan Province’s method was this: capital formed by state enterprises before the 1983 policy of "profits converted into taxes" (li gai shui) reverted to the ownership of the state; capital formed thereafter was separated into two parts: a. capital formed by using state allocated “floating capital” that enjoyed tax reduction or exemption became the state’s; b. other capital reverted to the ownership of the enterprise.

(7) Public offerings were not controlled by a planned quota, but could be made subject only to approval by the local branch of the People’s Bank of China, the central bank of the PRC. Because a company could either directly issue the shares itself or entrust to issue to the local bank, issuing costs were one percent or less of those in 1993. See Municipal Temporary Measures, supra (5), art. 10.

(8) After incorporation, at least on paper, the new company was freed of its former subordinate relationship to administrative agencies in charge of that industry (hangye zhuguan bumen). See Municipal Temporary Measures, art. 26; Provisional Plan, supra (5), art.26. The planned economy in China formed this as yet substantially unchanged control system. Above every state or collective enterprise, there is an administrative agency in charge (xingzheng zhuguan bumen), which is the state’s agent, wielding government power and serving as a parent (literally, mother) company that participates in the enterprise’s policy making. The division of enterprise control authority between the national and local governments was nor arranged by law but has de facto evolved over the years. The central government’s enterprises are controlled by the relevant ministry or commission under the State Council, while the relevant department (ting) and bureaus (ju) of provincial and local governments control their own enterprises. Mao Zedong once referred to this system as “breaking things into pieces” (tiaokuai fenge).


158 Id.
Development Bank were traded on the Shenzhen OTC market. Many unofficial securities trading markets also existed periodically, among which the ‘Red Temple’ market in Chengdu, the capital city of Sichuan Province, is the most well-organized and biggest one. Hundreds of thousands of shares were traded in this curb market like fruits and vegetables until it was closed by Chengdu Municipality before its one-year birthday in 1988.\textsuperscript{159}

To be sure, some of the local rules from the period of experimentation have been amended and accepted in the central government’s corporation scheme: for example, the separation of state, legal person, and individual shares according to the identity of the holder.\textsuperscript{160} However, as we shall show in the next section, the central government found the absence of a universal matrix, negligible mandatory rules, and predominance of optional clauses an unsettling consequence of local regime control. It therefore set out to interfere in the experimentation.

\textbf{B. Rectification and Consolidation Period}

The Tiananmen Incident (June 1989) abruptly interrupted the ongoing trend towards a more diversified economic structure both in academia and on the experimental

\textsuperscript{159} See Liu Haibin, \textit{Cong hongmiaozi shichang guanbi suo xiangdao de} [Thinking From the Closure of Red-Temple Market], Chengdu Daily, 1988.

\textsuperscript{160} Municipal Temporary Measures, supra note 156, arts. 3-7.
In the months following the June incident, the debate over the future direction of SOEs took on a very one-sided character. In the media, only the most conservative voices could be heard and their message denounced joint stock companies as exploitative capitalistic sweat shops. Accordingly, the Central Government adopted measures to ensure the leading role of public ownership and thus limit legal experimentation in regard to incorporating SOEs. The Central Government's actions manifested the sharp ideological disputes engendered by corporatization as well as the Chinese economy's entry in 1989 into a period of "rectification and consolidation" (zhili zhengdun). As an apparent cause of the dispersion of financial resources and reduction of central government income, stock issuing became one of the important foci for rectification and consolidation.

In May 1990, the State Commission for Restructuring the Economic System (SCRES) formally proposed guidelines for differential treatment of dissimilar types of companies.\textsuperscript{161} These guidelines provided for active experimentation where enterprises hold each other's shares but limited experimentation in the issuance of shares where internal employees held shares. The guidelines further provided for systematic experimentation in Shanghai and Shenzhen, leaving experimentation elsewhere squarely under control of the central government.

By December 1990, local branches of the People’s Bank were deprived of the power to approve the public offering of any shares.\textsuperscript{162} In Shanghai and Shenzhen, the issuance of new shares by SOEs with outstanding public shares became subject to the approval of the local branch of the People’s Bank. New initial public offerings are subject to approval of the Head Office of the People’s Bank.

The internal fund raising measures of enterprises were also brought under the unified control of the headquarters of the People’s Bank.\textsuperscript{163} Provincial branches of the People’s Bank of China are responsible for enacting the headquarter’s rules at the local level. Provincial branches distribute the quotas for internal fundraising distributed by headquarters and exercise their assigned powers within the scope of the quota.

The headquarters further exercises its authority by banning the establishment of securities companies or other financial institutions without its approval\textsuperscript{164} and by

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\textsuperscript{163} Zhongguo renmin yinghang guanyu jiaqiang qiye neibu jizi guanli de tongzhi [1990 Notice of the People’s Bank of China Concerning Strengthening the Management of Capital Accumulated within the Enterprise], reprinted in Collected Securities Laws, at 121.

\textsuperscript{164} Zhongguo renmin yinhang zhengquan gongsi guanli zanxing banfa [People’s Bank of China Interim Methods for Regulating Securities Companies], reprinted in id. at 151.
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requiring that it approve the listing of shares by joint-stock companies in Shanghai and Shenzhen. 165

In addition to the powers of the Head Office of People’s Bank, the State Council has further centralized power over the Chinese securities market through the establishment of the “Working Conference on the Securities Market.” This body--the highest level organization in charge of the securities market--is led by the People’s Bank and includes members from the Ministry of Finance, the State Planning Commission, SCRES, and other central government departments. All public offerings and listing of stocks are subject to the approval of the Working Conference on the Securities Market.

Despite this reversion, by early 1990 the reform process was back on track, as indicated by the all-out preparation and eventual opening of the Shanghai166 and Shenzhen167 Stock Exchanges, however quietly. The two organized stock exchanges opened for business in 1990 where 13 companies with a total capitalization of RMB240m (US$1=RMB8.3) were listed. At present, these two stock exchanges are the only two authorized exchanges operating in the PRC, although there has been pressure at the provincial level to establish more. The trading of shares on the Shanghai and

165 Id., at 164.

166 In December 1990, the Shanghai Stock Exchange opens its doors to the public. See Beijing Review, Feb. 24-March 1, 1992, at 16.

167 In April 1990, the Shenzhen Stock Exchange was formally opened. See Chinese Youth Daily (Zhongguo qingnian bao), 4 July, 1991, at 1.
Shenzhen exchanges is limited to securities listed thereon, while unlisted securities continue to be traded on OTC markets located in various major cities around China. On December 5 1990, a Securities Trading Automated Quotation System (STAQS)\(^{168}\) for legal person shares was set up in Beijing by the Stock Exchange Council (SEEC) under the SCRES. Initially, STAQS linked approximately 30 cities and 80 licensed trading corporations in China, with an average monthly turnover of over RMB 600m.\(^{169}\) Incorporation of SOEs also made great progress during this period: by the end of 1991 there were about 3300 PRC enterprises which had converted themselves into "limited liability joint-stock companies", having issued legal person shares or individual shares.\(^{170}\)

The phenomenal growth of the stock market reflects the enthusiasm of companies (most of which were SOEs) to raise funds through the capital market as well as to gain more independence from the government. Unfortunately and more

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\(^{168}\) In May 1993, another trading center devoted to legal person shares was opened with the backing of the People’s Bank of China--China Securities Trading System Limited (NETS). However, for a number of reasons, the market for legal person shares never became the gold mine some people imagined. The Shanghai and Shenzhen exchanges constantly adopted measures to prevent STAQS and NETS from siphoning off the capital in their exchanges. Companies which had already listed on the Shanghai and Shenzhen exchanges were not permitted to allow their legal persons shares to circulate on either STAQS or NETS, and companies which had already listed their legal person shares on STAQS or NETS had no hope of listing their individual shares on the exchanges. Indeed, in June 1993, the Shenzhen Municipal government issued an order to this effect. Without specific permission, no Shenzhen company “could on its own authority prepare to list on the Beijing legal person share market [i.e., STAQS or NETS] and no local securities company could “act in Shenzhen as the transaction agent for Beijing legal person shares.” See Zhongguo shichang zhoukan [Securities Market weekly], 1993, no. 27, at 23.


\(^{170}\) See Robert Nottle, supra note 157, at 505.
importantly, the government has failed to realize that the corporatisation process is no longer just a small-time experiment but represents a solution for the chronically money-losing state sector on a much larger scale.

C. Expansion and Standardization Period

During Deng Xiaoping’s early 1992 tour of southern China, he spoke repeatedly of the need to accelerate reform. The expansion of the experiment in corporatisation clearly echoed these remarks. In January, SCRES presented a plan in its annual ‘Key Points of the Restructuring of Economic System.” In the special economic zones in Guangdong, Fujian, and Hainan provinces experiments could be made in publicly offered shares not listed or traded on exchanges. The measures and amount of issuance were to be jointly examined and approved by the People’s Bank and SCRES. In Shanghai and Shenzhen, the plan provided that the numbers of listed companies should be increased in a planned way. In other areas, the policy was to develop legal person shareholding

171 See Qian & Chen, supra note 25.

172 At the beginning of 1992, during Deng Xiaoping’s progress through southern China, he publicly warned against the forces obstructing reform and called for expanding and accelerating the reform. These remarks caused a dramatic shift in the stock markets of China. See Wu Xianman, Deng Xiaoping nanxunhou zhongguo gushi de xin fazhan [The New Development of China’s Stock Market After Deng Xiaoping’s Southern Progress], Zhongguo zhengquan pinggu [China Securities Rating], 1994, no.2, at 12.

limited liability companies, joint-stock companies, and enterprise groups. The scope of internal employee shareholding was to be expanded in a planned and incremental way.

In April of 1992, SCRES and the Production Office under the State Council clarified the procedures for the examination and approval of the listing of shares. Outside of Shanghai and Shenzhen, the listing of any shares had to be examined and approved by the Working Meeting of the State Council on the Listing of Stocks.174

As the experiment expanded, the ministries and commissions began to promote a uniform and standardized corporation model. From May to December 1992, around ten ministries and commissions of the central government separately or jointly promulgated fourteen administrative rules formalizing the corporatization experiment. These rules covered joint-stock companies, limited liability companies, and the securities market within each governmental organ’s jurisdiction. SCRES issued the two rules that drew the most attention: The Opinion on Standards for Limited Liability Companies and The Opinion on Standards for Joint-stock Companies (Standards Opinion).176


175 The ministries and commissions included SCRES, the State Planning Commission, the Ministry of Finance, the Ministry of Labor, the Ministry of Personnel Administration, the Ministry of Material Supply, the State Land Administration, the State Bureau for the Administration of State Assets, the State Taxation Administration, and the State Scientific and Technological Commission.

176 Standards Opinion, supra note 153. As used throughout this Article, the abbreviation, “Standards Opinion,” refers to only the Opinion on Standards for Companies Limited by Shares.
Under this national regime, SCRES, or provincial commissions for restructuring economic systems, hold the power to approve or refuse the application for initiation (the most important permit needed for the establishment of a joint-stock company). They will only accept applications from companies that have received permission to apply from the administrative agency in charge of their trade or industry. This request for permission to apply implies that certain of an individual’s right in private and public law, have been absorbed by the administrative department in charge of the individual’s industry or trade. Therefore, the individual may claim only those rights subject to the administrator’s consent. Thus, governmental organs which are obliged to protect the individual’s rights are responsible only to the competent administrative departments, not the individual possessing such rights.

Other powers involved with the corporatisation of SOEs are vested in various central government organs. The People’s Bank controls the permit power for the issuance of shares—whether or not an IPO—as well as the power to formulate and

177 In 1992, an ad hoc organization—the Office for the Joint Examination and Approval of Shareholding Experimental Units—was established in each province. The provincial Commission for Restructuring Economic System is the core of the Office. See Fang Liufang, Approval Procedures for the Establishment of Companies in China, Social Science in China, 1993, no.4, at 167-84.

178 An agency in charge of a trade or industry is a central or local government organ that within its authorized scope exercises governmental power in regard to all legal and natural persons in that trade or industry. Moreover, in matters outside its own jurisdiction that require approval by another government organ, it either permits or represents the legal or natural persons under its supervision in seeking approval from that other governmental organ.
distribute issuance quotas. The State Bureau for the Administration of State Assets exercises the power to affirm assessments of state-owned property and to approve the transfer of state shares. It also participates in the examination of the application for initiation. Property powers are vested in the State Land Administration, which is responsible for investments involving the sale, transfer, or lease of the land use rights.

Where the initiation of a joint-stock company concerns a new construction project, or a SOE that formerly implemented the state’s mandatory plan is to be reorganized into a joint-stock company, the State Planning Commission may possess the authority to issue the power of initiation permit. If the promoter is registered as a high-technology enterprise, the State Commission on Science and Technology will participate in the examination of the application for initiation. Only after promoters of

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179 Guowuyuan hangongting guanyu xiang gongkai faxing gupiao de gufenzhi shidian wenti de tongzhi [Notice of the Central Office of the State Council Concerning Problems in Share System Experiment Enterprises Issuing Stocks to the Public], 1990.


183 Guojia kexue jishu weiyuanhui guanyu zai guojia gaoxin jishu changye kaifaqu changban gaoxin jishu gufen youxian gongsi ruogan wenti de guiding [State Commission on Science and Technology Provisions on Several Questions Concerning Startups of Joint Stock Limited Liability High Technology Companies in State High Technology Industry Development Zones], reprinted in id., no.4, at 301.
corporations have obtained permits from all relevant governmental organs will the State Administration of Industry and Commerce handle the registration procedures.

In the current environment in which every agency urgently seeks to extend its bureaucratic power, this system of allocating powers to approve corporatization experiments encounters bureaucratic problems. In July 1992, the President of the People’s Bank convened the National Working Conference on the Management of Securities, including delegates from more than ten central government organs. This Working Conference, which supplanted the 1991 Working Conference on Securities Markets, established its permanent office within the People’s Bank and decided to organize China Securities Regulatory Commission (CSRC). Vigorously guarding its turf, the Bank objected to establishing a committee above the CSRC, an idea then under discussion. The Bank concluded that: “under the current circumstances, it is unrealistic to set up a nation-wide unified and centralized organization.” The Bank felt that a

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184 It is impossible to accurately define the powers of a specific government agency itself. Without subsequent recognition by the State Council, one agency’s power does not have binding force over other governmental organs at the same level. Furthermore, governmental organs divide their permit authority into sub-permits so as to produce work for the organ’s subordinate bureaus and departments. Governmental organs have also proven adept at creating permit procedures for newly developing areas not covered by existing permit powers. With the proliferation of new areas and the ever finer divisions within industries, conflicts among the licensing powers of different government organs appears to be a permanent fact of life. Thus, promoters of corporations must supplicate different government organs or apply to one government organ several times.


187 Id.
national organization could be established when the securities market had matured. Clearly, a less powerful Working Conference better served the People’s Bank’s aim of maintaining its leadership role in developing the nascent securities markets.\textsuperscript{188}

\textbf{D. The Establishment of CSRC}

Prior to 1993, Shanghai and Shenzhen issued shares by lottery.\textsuperscript{189} To enter the lottery, a subscriber would fill out a numbered lottery form obtained from the underwriter and pay RMB 400 in earnest money. The underwriter then provided an identically numbered subscription order receipt, which served as the lottery number. The unlucky got their earnest money back. In 1992, Shanghai and Shenzhen publicly issued share subscription certificates and share subscription lottery forms, respectively (practices the central government extended nationwide the following January).\textsuperscript{190} This

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\textsuperscript{188} Zhengquan bangongshi fuzenren tan zhengquan guanli tizhi [Senior Official from the Securities Office Discusses the System of Securities Regulation], Zhengquan touzi zhoukan [Securities and Investment Weekly], 1992, no. 16, at 1.
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\textsuperscript{189} By 1993, the central government also adopted two other means by which one was selected to purchase stock. One method was unlimited subscription application forms. The second method was to connect subscription to savings accounts in banks. Of the 100 companies that issued shares in 1993, 98 used the former method. See Zhengquan weiyuanhui guanyu 1993 nian gupiao fashou yu rengou banfa yijian [China Securities Regulatory Commission, ’Opinion Concerning Methods of Sale and Subscription for 1993 Shares"], Bulletin of the CSRC, 1993.
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\textsuperscript{190} See Shanghai zhengquan bao [Shanghai Securities Daily], jan.13, 1992, at 1; Shanghai zhengquan bao, Feb.10, 1992, at 1. In January of 1992, the Shanghai municipal government sold 2.087 million share subscription certificates which were valid for the whole year and cost RMB 30 each. There was no maximum limit on an individual purchase and the sale netted a total income of approximately RMB 62.24 million. In 1992, Shanghai held four lotteries, none of which had a preset chance of success, and which, together, resulted in individual winners subscribing to roughly 400 million shares. Also see Zhengquan shichang zhoukan [Securities Market Weekly], 1992, no.6, at 3; Zhengquan shichang zhoukan, 1992, no.7 at 3. In August 1992, the Shenzhen municipal government sold 5 million share subscription lottery forms, each of which was priced at RMB 100. It also sold 500 thousand share
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system was implemented as a measure to solve one of the problems common to an emerging market in a state such as China: simply put, "crowd control". At the time the system was introduced, demand for new shares far outstripped supply, leading to illicit practices in share distribution at the time of IPO. Despite the new adoption of this system, on August 10, 1992, public's panic purchasing and official corruption during the sale of the forms in Shenzhen led to street demonstrations and bloody conflicts.\textsuperscript{191}

The "Shenzhen August 10th" event directly prompted a diminution in the power of the People's Bank. The central government felt things were getting out of control. The PBOC and its local branches had been charged with regulation but were clearly not up to the job. Hence on October 25, 1992, the State Council decided to disestablish the National Working Conference on the Management of Securities and organize the Securities Policy Committee (SPC) and the CSRC.\textsuperscript{192}

\textsuperscript{191} See Zhengquan shichang zhoukan, id. Tens of thousands of investors, who had lined up overnight to obtain stock applications, rioted when they discovered the following day that many applications had already been issued to work units that had connections with the issuing companies and stock exchange.

\textsuperscript{192} Guowuyuan jueding jianli quanguo zhengquan guanli weiyuanhui [State Council Decided to Establish National Securities Regulatory Commission], October, 1992, Zhengquan shichang zhoukan [Securities Market Weekly].
The duties of the SPC were defined in the December 17, 1992, No. 68 Circular of the State Council, which delineated various ministries and commissions administrative authority over the securities markets. The SPC was charged with:

1. Drafting the laws and administrative regulations concerning the securities market;
2. Researching and formulating guidelines, policies, and rules concerning the securities market;
3. Enacting a comprehensive plan for the development of securities markets and making planning suggestions;
4. Directing, coordinating, supervising and inspecting various departments involved with the securities market;
5. Overseeing the CSRC.

During the past 5 years of development of the securities market, the SPC has played a limited role even though it is supposed to be the highest regulatory body in the nation. The SPC is comprised of ministers from 16 ministries under the State Council and this number has been steadily growing from the original 13 ministries, as the Vice-Premier-In-Charge believes that all the ministries that have anything to do with the

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193 Guowuyuan guanyu jinyibu jiaqiang zhengquan shichang hongguan guanli de tongzhi [Notice of the State Council Concerning Further Strengthening the Macro Regulation of the Securities Market], reprinted in Compilation of New Laws, supra note 30, 1992, no.4, at 262.

194 Id.
securities market need to have a seat in the committee. This is another manifestation that the SPC is just a joint conference mostly for ego satisfying and occasional turf coordinating purposes rather than a permanent establishment with substantial power.

According to the No. 68 Circular establishing it, the CSRC—a non-official organization able to exercise governmental power only with the authorization of the SPC—does not itself possess the authority to issue administrative rules. Instead, the CSRC proposes and drafts “methods” concerning the management of the securities market. Such “method” are made effective only after they are approved and promulgated by the SPC. However, the CSRC has broad supervisory and regulatory powers over the actual issue and exchange of securities. After May, 1993 when the State Council Interim Regulations of Share Issuance and Trading (the Interim Regulations) was passed, the CSRC obtained most of the major powers to regulate the PRC securities market.

Thereafter, other governmental organs no longer had the power to directly interfere with the securities market. However, the following governmental institutions do have roles to play in the securities market. The State Planning Commission is responsible for working out the volume of stocks and debentures to be publicly issued each year. The People’s Bank regulates broker-dealers through permits to open and operate (although the CSRC maintains the right of supervision and control). Likewise, the Ministry of Finance and the Ministry of Justice are responsible for the administration
of accountants and lawyers respectively, though accountants and lawyers engaging in securities work are required to get an operation permit from the CSRC. The SCRES is responsible for the drafting of relevant laws and regulations for shareholding experiments as well as the organization and coordination of shareholding experimental enterprises. However, the powers to govern the stock exchanges, which the SCRES conferred upon itself in the Standards Opinion, are not recognized by either No. 68 Circular or the Interim Regulations.

E. The Early Period of CSRC

The SPC-CSRC regime was established at a very difficult time. On the one hand, according to the official view, China’s securities markets are still only “experiments” in capitalism with the implication being that if all does not go well they may be abandoned.\(^\text{195}\) There have been elements within the State Council that do not think securities are such a hot idea. On the other hand, the ministries which lost their powers over securities markets because of the SPC and CSRC would find any opportunities to restrict the development of CSRC. There have been hot debates over the regulatory

\(^{195}\) During Mr. Deng Xiaoping’s famous southern tour, he also stated his rationale for allowing the experiment, “we can always close it down if it does not prove to be conducive to our socialist market economy.” See Speeches by Comrade Deng Xiao-Ping During His Tour of the South, the People’s Press, 1992. Deng’s words have been quoted by some of the most conservative party leaders who view the stock market as a negative influence to the stability of the Communist Party’s leadership. This faction wishes to restrict the growth of China’s securities industry (as part of an overall effort to retreat from the privatization process) which is one of the major components of China’s current economic reform program.
The result of the two forces is that CSRC sees its role extending far beyond regulation and investor protection. The CSRC is not there just to set up basic rules and see they are obeyed. Its role as a securities regulator is all-embracing. In conjunction with the SPC, it has a kind of overall responsibility for the performance of the markets. From the more than four years’ history of CSRC and SPC, we can always find that their regulatory purview has grown sporadically in reaction to events.

In July 1994, to counteract a long fall in the value of the A share index, the CSRC issued the so-called ‘Three Big Policies’ among which the most important one is to put a moratorium on new issues. The idea was to raise prices by restricting supply. As the World Bank puts it: ‘This amounts to unwarranted market manipulation of a major nature.’ Ironically, this kind of activity has, if anything, contributed to market volatility. The announcement of the moratorium on listings and a market-support package led to a jump of 122% in the A share index in less than a week. According to the World Bank report, rather than making things run more smoothly “the succession of regulatory events generated by the government” has been a major contributant to market


volatility". The CSRC now admits the move was a mistake—it began approving listings again at the end of 1995. But there have been no indications that it will lessen government involvement in the listing process. The government, and not the exchanges, will continue to determine which companies are listed.

Another typical example is the bond futures scandal in February 1995. One of China’s premier brokerages, Shanghai International Securities Company (SISCO) lost virtually its entire capital when a punt on a central bank inflation index announcement went badly wrong. According to the regulations of Shanghai Stock Exchange and CSRC, SISCO had gone well beyond the authorized trading limits. This event, from the point of view of officials in Beijing, is the most damaging incident yet for the reputation of China’s securities markets.

The impact of the scandal is far-reaching in two respects: firstly, there was a wave of changeover in personnel throughout the securities industry in 1995. The dismissal of the CSRC’s free-thinking chairman, Liu Hongru, and his replacement by the more bureaucratically minded Zhou Daojiong—formerly at the policy-making State Development Bank—was the most important sign of a change in philosophy among China’s leaders. Most of the senior officials in the CSRC including several vice-

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199 Id.

chairmen and the highly regarded General Counsel and Chief Accountant soon left due to the adjustment. The conservative approach imposed on the CSRC was quickly felt elsewhere in the securities circle. The president of the Shanghai Stock Exchange, Wei Wenyuan, who effectively founded the market and was renowned for his gung-ho approach to its development, was replaced by a municipal planning department official, Yang Xianghai. Secondly, after the incident, the CSRC was quickly given more authority over China’s securities markets. In the middle of 1995, regulation of the 25 or so exchanges outside the main markets of Shanghai and Shenzhen--mostly bond trading centers--was put under formal CSRC control. Authority over Shanghai and Shenzhen Stock Exchanges soon followed. In January 1996, the B share market, reserved for foreign investors and previously the responsibility of local governments, was also directly regulated by CSRC.

The message was clear: the central government has decided that the only way to address current problems such as wild volatility and speculative frenzy on domestic exchanges is to slow down securities market expansion and tighten regulation over the whole market. The bureaucratic slogan that has been selected to characterize these changes is one comparing the virtues of “standardization” (meaning improved regulation)

201 Sophie Roell, Reining in the Free Market, Euromoney, July 1996.


with "development" (meaning market growth). The former is to be favored over the latter.
Chapter IV The Prospect of China’s Securities Regulation

A. The Century-long Debate Over the Choice of China

During last few years, two sharply disparate assessments of the current corporate experiment in China emerged. Some people like many foreign scholars of contemporary Chinese law, find a state determined to use the law in instrumentalist fashion. From effect they infer intent. Still driven by the mentality of “the plan,” the state has halted experimentation, imposed standardization regardless of costs, and not so coincidentally served its own interest. Other people defend the instrumental actions of the state,

204 See, for example, articles on China’s legal reform in 141 China Q. 1-210 (1995).

205 See, for example, Han Zhiguo, Zhongguo fazhan gufenzhi de lu gai zemme Zou [How Should China Go Along the Road to Developing a Share System], Zhongguo zhengquan bao [China Securities Daily], Aug.11,1993, at 6. He made the following comment on this question:

In establishing a joint-stock company, one must go through the process of examination and approval [Shenpi] by the competent administrative agency. From a certain perspective, the enterprise’s dependence on administrative power is greater and more serious [than under the prior system]. It is only the form of dependency and government agency that has changed. . . . Comparing the traditional planning regulation under the old system to the power held by competent government organs to approve a quota for shareissuance and to choose which enterprise may list, it is hard to say which is worse, but regardless of how great entrepreneurs’ skill or contribution may be, standing before administrative authority they must all bow their heads and acknowledge their vassalage [Fushou chengchen]. . . . If one says that at present our nation’s share economy is not standard, then I think even more important than the lack of standards in the forms and procedures of operation is that the legal documents concerning the share economy not only are not standard but are also suffused by an administrative coloration.

See also Fang Liufang, “China’s Corporatisation Experiment” (1995) Vol. 5, No 2 Duke Journal of Comparative & International Law, 149-269. He said:

Under this legal framework, whether one considers it from the perspective of their seriousness or from the perspective of the difficulty in resolving them, man-made problems are significantly greater than those that can be attributed to the market economy itself. There are at least five major problems with the existing legal framework:
arguing that planning and control are both inevitable and necessary in the transition to a market economy in spite of the fact that things have not always turned out as intended. They point out that some of the issues which may seem problematic to the observer are practical to the practitioner and in fact represent measures that were adopted in an effort to insure the continued and successful development of the corporatisation process.

(1) One day the gates will be opened and several billion "directed placement" (Dingxiang Muji) shares which have been deprived of their right to enter the market, will be thrown into the market by the huge number of shareholders anxious to transfer their stock. There will be inevitably a sharp price drop. Investors will be unable to recover their principal unless even more of society's savings enter the stock exchange market once the gates are opened, or the issuing market is temporarily closed. Either circumstance will produce a huge waste of society's resources.

(2) After establishing an unstable, sporadically open securities market with barriers dividing the various types of shares and stock issue quotas, to suddenly remove the barriers and completely open the market could lead to disaster. In the issuing market, after the government, securities dealers, lawyers, accountants, and issuers have all distributed among themselves the issuing income that is more than ten times the face value of the shares and that comes largely from individual shareholders, even more individual capital flows into this narrow stock exchange market. It exerts itself to keep stock prices propped up above the subscription cost so that a profit can be earned when shares change hands. It seems that the costs expended in the process of issuing can be completely recovered in the exchange market. But in an exchange market where the total amount of capital fluctuates within a narrow range, individual shareholders can realize a profit only if the large number of "frozen" shares issued to and held by the state and legal persons are excluded from the market by the barrier of listing permission. Any measures that would eliminate the barriers or open the market would dilute the capital already in the trading market and cause panic selling.

(3) Under the system of stock issue quotas, a large amount of resources are wasted for no reason, ordinary order is assaulted, and all written rules become meaningless.

(4) Permission to issue and list shares leads to repeated arbitrary administrative decisions. Faced with mutually contradictory ambiguous administrative rules and regulations, parties are totally at a loss about what to do. It is not so much the formation of rules as it is the formation of unconstrained power.

(5) Given the complex, multi-stranded ties between the government organs that possess the power to set the quotas for issues and to permit the issuing and listing of stocks on the one hand and the securities dealers, lawyers and accountants who receive special permission from those authorities on the other hand, insider trading and market manipulation may be ever more hidden and dangerous.

The two opposite arguments are not new from the history point of view. In China, Confucian reformers traditionally fell into two types. Optimistic reformers argued that a mere change of institutional arrangements could tap the energies of officials and people to produce an immediate transformation of society. For example, the early Qing decentralizers such as Liang Qichao, Yan Fu, and Luo Longji demanded power for the people, claiming that democratic institutions would bring quick results in national dynamism and modernization. Confucian pessimists, on the other hand, perceived society as backward, and argued for long-term indoctrination and education by moral example to teach people to see their higher interests in those of the collective. Liang Qichao became such a pessimist after a tour of America in 1903. He suggested in ‘On Enlightened Despotism’ that China must have an autocracy that would rule in the public interest and gradually raise the level of popular education and civic consciousness until the conditions were ripe for a transition to constitutional monarchy.

In seeking the ultimate roots of bureaucratism, the China Communist Party (CCP) reformers in the post-Mao era rejected Mao’s theory of a corrupt ruling stratum or democrats’ accusation of the socialist system. They returned instead to the theory of cultural backwardness that Liang Qichao had used to explain his conversion to the


theory of enlightened dictatorship. The source of bureaucratism, the party press explained, was China's 'feudal cultural tradition'. The main reason of Liang and CCP's reticence about the dangers of despotism was their perception of China's weakness in the Darwinian struggle among nations. The urgent message of all their arguments was national solidarity for survival. Rather than checking the power of the ruler, they wanted to enhance it.

Like the early Liang Qichao and other reformers in China's tradition of Confucian optimism, however, the democrats seemed to see institutional change as needing only to be ordained to be successful. To them, pluralist reform was similarly a matter of making up one's mind as to its desirability, and so they concentrated on demonstrating the benefits of their proposed reforms, as if this were all that was needed to make the case for adopting them. By default, they left the task of evaluating their ideas' practicality to those who feared, in the pessimistic tradition of the later Liang, that society was still too backward to allow the people to hold real power. In fact, China's century-long obsession with political order and national strength has made it impossible for most other Chinese, even non-Marxists, to share the democrats' vision of change.

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209 See Red Flag 24 (1980), "Even though the socialist economic system had been established for thirty years, the concepts, habits, and traditions of feudalism, formed and developed over the past several thousand years, are deep-rooted."; Red Flag 14 (1980), "bureaucracy exists within our party because the influence of the nonproletariat within the party is very strong--that is, because of the party's peasant base--and it is more so because of the inadequate standards of education of China's proletariat and laboring masses."); China Youth News, 7 February 1981, "the bureaucratic phenomenon found today is not inherent in the socialist social system, on the contrary, it is a force alien to socialist public ownership and is the opposite of people's democratic dictatorship."); see also People's Daily, February 1981, "eliminating the pernicious influence of feudalism from the people's mind would take time. In the meantime, only stability and unity could promote democracy."
B. Specific Example in the Area of Securities Regulation

Opponents of current securities regulatory system argued in the same line as the democrats in the political sphere. Some critics favor a "system" (if there was one) before the centralization and regularisation process of the securities market begun five years ago.\(^{210}\) The argument being that in the early stages there were not so many mandatory

\(^{210}\) See Fang Lufang, supra note 204. Fang's article is representative of a myriad of critics from the academics and securities industry to the legislature. The following is a list of the more common, yet more serious and dangerous criticism of the system and its designe:

1. the establishment of one prophetic criterion against which the successfulness of the corporation experiment is to be evaluated: namely, whether or not "public ownership" was strengthened (in China the term of "public ownership" refers to the system of state and collective ownership. Public ownership or state ownership still carries a connotation of political correctness within the Chinese officialdom even as of today);

2. the retroactive application of laws, regulations and even impetuous policy changes to companies that were established long before the promulgation of the same laws and regulations;

3. the unnecessarily hair-splitting division of power (hence tangible interests) among the various government ministries, as well as central and local governments and business entities;

4. the unconstitutional (and ultra vires) delegation of power by the State Council to the SPC with regard to the formulation of securities-related laws and regulations, and to the CSRC with regard to its regulatory and enforcement (hence government) power;

5. the establishment of, what critics call a draconian agency (the CSRC), with extensive regulatory power that is neither subject to the checks and balances of the administrative appeal nor judicial review process;

6. the creation of a public offering approval system that stands on its own head, namely, catch-22 type requirements for companies aspiring to issue shares to the public, and the pre-determination of candidates, a practice that vitiates any necessity for required material approval (this refers to a system as established by the Interim Regulations of approval for public offering and listing based on merit or quality of a company);

7. the creation of a listing approval system that gives de facto approving power to the CSRC without subjecting it to any liabilities;

8. the institution of a wasteful, inefficient, unfair and irrational lot-drawing (plus mandatory underwriting) system for public offerings that promotes gambling; a system that deprives the company
rules and regulations as exist today, and most of the rules were elective as opposed to mandatory. Critics actually suggest that the earlier system was a better one, implying that with no rules, life was easier. Furthermore, critics attribute the apparent disparity, between the old system and the new, to the designers of the system, believing that they established a procrustean/universal model to be applied to any situation without considering the context. I will take division of ownership and management as an example to respond to these critical comments so that readers can get a feel of the complex nature of the legislative and implementing process in a transitional economy.

97 of capital as potential investors spend money on lottery tickets that could otherwise go to the company; the lottery system also forces new investors to pay unreasonably high prices for their new shares;

(9) the institution of an ineffective and anti-market stock-offering quota system;

(10) the unreasonable, controversial and self-serving mandatory use of legal, accounting and other professionals as a part of the approval system; a practice that creates conflict of interests and encourages corruption;

(11) the artificial classification of company stocks by virtue of their holders’ legal status as opposed to the intrinsic characteristics of the stocks themselves;

(12) the irrational permission given to the promoters of the company to subscribe to the company stock at a substantially lower price than that for the general investing public;

(13) the false assumption that the division of power between ownership and management, resulting from corporatisation, could lead to a more efficient economic system (and that freedom of contract is thus infringed upon).

This list could continue, but the antagonism and intensity of the arguments levied by critics are already sufficiently exemplified in the above.

211 E.g. rules regarding the articles of association of certain companies, disclosure in prospectuses and semi-annual reports, etc.

212 Speech by Feng Ailing, Deputy Director of Macroeconomics Reform Department, SCRES, at the Sino-Singaporian Financial Symposium, Capital Masion, Beijing, 2 November, 1995.
Critics claim that the separation of ownership and management has failed to produce greater efficiency and is not necessarily an appropriate structure for Chinese companies. They believe that all the bureaucratically institutionalized rules and old habits embodied in the SOEs have been incorporated into the joint stock companies.


In their view, joint-stock companies do not necessarily lead to the separation of the right of ownership and the right of control. Separation of ownership and control occurs only when the shareholding is so dispersed that there is no way to constitute either majority or minority control, so dispersed that a single shareholder, either on its own or in league with others, can not influence the board of directors. Though the beneficial owners of the company's property, shareholders have lost any means of control and can only 'vote with their feet' (Yongjiou toujiupiao). As the recipient of the owners' entrustment, the directors and the managers acquire a sort of power without property right—the right to control the company. Separating control from ownership is not necessarily the path to efficiency and fairness; rather the separation appears following the distribution of the share right and ought to be a phenomenon increasingly subject to adjustment by law. They believe, in contemporary China, more and more evidence shows that the injury caused to companies by directors and managers' conflicts of interest is no less serious than that caused by excessive government interference. They argue that under the current legal framework there is still neither a reliable method for preventing this sort of problem nor a channel for stockholders to obtain judicial relief.

214 Id. The critics believe that regardless of what path SOEs have taken to reorganize into joint-stock companies, ownership and control have not been separated. If there has been any change at all, it would be that after corporatization, the controlling shareholder not only continues to have authority over its own property, it also has authority over what may be the even greater property of other shareholders. In a situation in which the state's shares may not be transferred and the number of shareholding individuals is limited, the way in which majority and minority shareholders relate to control of the company is unwavering and the possibility of a takeover by outside shareholders is completely eliminated. Moreover, the old systematized internal rules and customs of enterprises will be transferred to the body of the new share company. Consequently, until the state shares are dispersed to a certain degree, corporatization has no way of accomplishing a separation of right of ownership and right of control.

They argue that the chief reason for the lack of vitality in state enterprises is the excessive and willful administrative interference, a problem unrelated to the right of ownership or control. When the government interferes in enterprises, it has absolutely no need to use its ownership right as a justification. Any activity that impinges on society's common interest falls within the scope of the government's intervention. If the government considers it necessary, it may interfere even more seriously in an enterprise in which it has no ownership right: for example, to nationalize a private enterprise, or to change a collective enterprise into a state one. Thus, even a thorough separation of the rights of ownership and control would not have a significant effect on the problem of administrative interference.
While there may be some hangovers from the former system in the newly formed entities, critics and investors alike should recognize that such a transformation is a process and takes time. Surely, companies that were established as private entities from the outset stand in an advantageous position because the ownership-management question was clear from the beginning. However, those formerly state owned companies making the transition should be given credit for their efforts. The numbers show that some of the listed companies are indeed performing quite well. Even those companies that are not doing well are forced to report their performance accurately, and are made accountable to their shareholders. If the shareholders do not like what they see, there is no law against selling.

Criticism of wanton and excessive interference on behalf of the government is irrelevant to the management ownership question. Of course, everyone, including the government itself denounces excessive and wanton interference in the management and operation of SOEs. In fact authorities are obsessed with the issue of reforming SOEs and making them self-sufficient and independent operators that respond to the need of the marketplace. For the past 15 years the government has been moving in this direction, in more recent years the pace has been accelerated. The point warrants to be emphasized again, that the transformation of a system, inclusive of all sectors, that is wholly based in state ownership to one that functions by the rules of the marketplace takes time and effort. China's effort to promulgate a bankruptcy law are a further indication of the seriousness of intent. Likewise, the enactment of the State Owned
Industrial Enterprise Law reduces, at least on paper, the government’s level of interference in enterprise management to an absolute minimum. Also as China prepares to enter the World Trade Organization (WTO), it will be forced to quicken the pace of enterprise reform in order to compete in a barrier-free regime.

Some opponents argue that the most efficient companies are the Taiwan and Hong Kong family owned and operated firms. Critics suggest freedom of contract and abolition of excessive government interference as a solution for the non-efficient companies. As far as this issue is concerned, let us recall the origins of China’s current regime. One of the more important objectives (and a reason) for the success of the Chinese communist revolution in 1949 was to overthrow a feudalistic society where a few corrupted families controlled the economic (and political) life lines of the whole country. The ensuing socialist movement to nationalize the economy greatly boosted the mass morale as well as the efficiency of the companies for a period of time. The establishment of a national system of state ownership proved to be a temporary solution, pulling China out of a very difficult period. However, this solution is no longer

215 They believe whether or not the separation of ownership and control is connected to efficiency is entirely contingent on the degree of distribution of the right of ownership. Family owned companies epitomize the unification of ownership and control. There is no evidence to show that family companies are less efficient than public ones. To the contrary, whether in the mainland in the 1930s or in Hong Kong and Taiwan in the 1990s, the most successful companies are family owned. From the end of the 1970s when individual commercial and industrial households revived, private enterprises without exception have unified ownership and control. But unlike SOEs, they have not lost their vitality because of this structure. The owner’s hiring of a manager and the manager’s control of the owner’s property are by their natures two utterly different things. For, regardless of the breadth of authority granted to the directors and managers, so long as the owner may dismiss and replace directors and managers, the control is still entirely the owner’s. However, when a dispersed ownership united to the greatest degree still lacks the strength to change directors and managers, having professional managers control a company is probably the best choice.
appropriate in such a comprehensive fashion, it is crippling the reform of the financial sector (a top priority of the state) and is costing the state vast sums of money to maintain. Hence the economic revolution initiated by Deng Xiaoping and the ensuing policy separating management and ownership. If a country has already experienced so much hardship and disillusionment under other systems, it is only natural that it would want to experiment with something new.

Since the demographic and geographic vastness of the state does not allow the experiment to proceed too rapidly, it would seem logical to start reducing total control of the economy by the government step by step. Such is the rationale for the current pace of the policy to separate ownership from management. The arguments put forth by critics of the present corporate and securities legal system, have little validity and paint a picture that is far more problematic in theory than it is in actuality. What is more significant though is that critics seem either unwilling or perhaps unable to enlighten their audience with their own alternative solutions under the present circumstances. One can not make general, sweeping criticism of an elaborate system without first familiarizing oneself with the system and taking into consideration all the relevant circumstantial factors, particularly given the fact that the system is still being established and will evolve and undergo many changes in the years to come.

C. The Opportunities and Challenges of Securities Regulation in China
Having said this, I do not believe there is no hope of seeing China turn into a market economy. There are certain promising signs in the process of Chinese corporatisation. Events in four fronts reveal the primary areas of future development. First, the National People's Congress (NPC)—China's legislative body—is about to approve and promulgate the Securities law, making it the first piece of legislation at the national level on the securities industry in China. This indicates that what has been called the "experimental" chapter for the infant securities program is probably complete. The promulgation of the new Securities Law will improve and strengthen the securities regulatory regime to the benefit of the overall growth of the securities industry in China.

Second, the central securities regulatory agency is becoming more assertive in regulating and enforcing the securities rules and regulations. The use by the CSRC of its investigation and enforcement powers to maximum effect, by targeting highly visible companies such as Shenzhen Development Bank, Guangshen Railway Corp. Ltd., Shanghai Branch of China Bank of Industry & Commerce, Haitong Securities Co. and Shenyin Securities Co., illustrates the presence the CSRC has in the market and how it


217 At present the CSRC boasts only about 130 staff and that includes the chauffeurs, the secretaries, janitors. In fact, it has maybe 50 professionals doing the job. There has been talk of boosting this to 200—the maximum the CSRC is allowed according to the government's departmental quotas—but progress has been slow. The CSRC has twice the responsibilities of other regulatory bodies and less than half the staff. The Investigation Department of CSRC was established in 1996 after nearly four-year existence of the agency.

218 See, for example, Yi pi yinhang zhengquan gongsi shangsi gongsi ji ji fuzeren shoudao yansu de chu zhi [Several Banks, Securities Corporation, Listed Companies and Their Person In Charge Were Punished Severely], People's Daily Overseas Edition, June 13, 1997, at 1. Shenzhen Development Bank
will use the media to maximum effect in promoting both its role as a successful market manager and enforcer, treating all participants, be they big or small, the same.

Third, more and more Chinese companies are gaining access to international securities markets by listing and trading their stock in the Hong Kong, New York and London stock exchanges. The CSRC plans to choose another batch of large state-owned enterprises to issue and trade stocks abroad in 1997. The application of the internationally recognized principles in China will act as a fillip to the transformation which we are already seeing in China. We will see greater accountability of government agencies, more consistent enforcement of rules and possibly, a greater awareness all round of the needs of justice not only being done, but to be seen to be done! There is also the potential, through the auspices of the IOSCO, the WTO and APEC, for regulators and market operators in the world to find greater scope for co-operation.


220 New Group Of PRC Companies To Be Listed In Hong Kong, China News In Brief, Clifford Chance, January 1997.

221 The general principles of Most Favored Nation status to all contracting parties and the consequent failing away of trade barriers and the requirement for transparency in domestic laws and their administration will liberate emerging economies by making increasing demands on their governments for transparency of their rules and regulations and consistency in enforcement which can only serve to enable both their constituents and their foreign partners to find greater confidence in their markets. Of course, the WTO which will serve as the central institution for nurturing the principles of these accords has yet to stand the test of time. But I see much good will in east Asia, in no small part encouraged by APEC of which we have Australia to thank for its inception. I also see China joining as a founding
Fourth, and perhaps the most significant, China will seriously tackle the property rights issue by starting to transform large numbers of state-owned enterprises. The Third Plenary Session of the 14th Central Committee of the CPC, while sketching out a broad program of establishing "a socialist market economy," gave priority to the establishment of a modern and efficient enterprise system. Since state-owned enterprises still play an important role in China's economy, the commitment of Chinese government to transform them will be crucial to China's securities regulation as well as its economic development into the twenty-first century.

The above offers a glimpse of the opportunities. What of the challenges?

It is perhaps trite to state that the challenges ahead lie in harnessing the many opportunities before us. If I were to sum up China's philosophy in the harnessing of economic opportunities in one sentence, I would say that: it is the provision of a stable member of the WTO in the not too distant future. Also see APEC Plans Tariff Cuts In China In 2000, China News In brief, Clifford Chance, December 1996. China submitted its "individual action plan" (IAP) for liberalising trade and investment at a ministerial meeting of the APEC forum in Manila in November 1996. According to the plan, China will allow foreign brokerages to open branches by 2000, increase the number of branches of foreign banks and insurance firms, and study plans allowing foreign banks to handle the Chinese currency.


223 In 1992, out of the total of 37,065 industrial output value (100 million yuan), the state-owned industries occupied 17,824, nearly half of the total output value. See China: 15 Years of Reform, Beijing Rev., Oct. 25-31, 1993, at 20, 23.
and level playing field so that it may be relied on as a support for the transformation of
the ailing state-owned industrial enterprises and the modernization of the whole society.
I subscribe fully to this philosophy but I will be the first to admit that China is far from
any state of perfection in this regard.

Let us first look at China’s position as regards the need for capital. The Chinese
government has estimated that at its current level of physical infrastructure building and
assuming the current rate of GDP growth, some US $75 billion will be required annually.
By the year 2000, some US $ 0.5 trillion will be required. And this is only for physical
infrastructure. Add to this the thirst for housing and for social spending. Fixed
investments in housing has been estimated in an advanced economy as the United States
as 3 to 4% of GDP. In faster growing economies like China, the rate is almost certainly
going to be higher. There is thus easily another US $ 0.6 trillion by the year 2000
needed for housing. Add to this too the thirst for social spending. All this could add up
realistically to some US 1.5 trillion of capital which is waiting to be raised by the year
2000.

Add to this equation too, the rate of savings in China attaining over 34.4%. This
means that the thirst for capital can in good part be quenched domestically if there are
systems of intermediation which can enjoy public confidence. The thirst for capital and
the corresponding eagerness to quench this thirst has resulted in the fast growth of
China’s securities market. Equally, the very high volatility of the market have pointed to
problems of liquidity and confidence, and generally to the need for adequate market regulation.

Another more pressing issue to my mind is the ability of the investing public to understand the risks involved in investing in the listed and unlisted securities. The challenge will lie, on the one hand, in adequate and effective disclosure of risks and on the other, sufficient knowledge of the powers of comprehension and financial ability of their clients by intermediaries. The investing public must also be aware of their rights in what to expect from their intermediaries. The intermediaries too require to be informed of the new development in the market to enable them to provide the best service possible to their clients. I perceive the need for China to develop as soon as possible a strategic plan for the education of the public and the education of intermediaries.

But the inherent challenge lies in the "bureaucratic" nature of the securities regulation. The abuse of administrative power that is impeding China's smooth and stable transition from a planned to a market economy constitutes the most serious problem. From the "official profiteering" (guandao) of the 1980s to the "morphing companies" (fanpai gongsi) (literally, "turning over nameplate companies") of the 1990s, from the various noisome "assigned contributions" (tanpai) imposed on the peasants to the barriers at every stage along the road of state enterprise corporatisation—all are

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224 See Chapter I for the discussion of "economic administrative law" and "political administrative law" in China.
related to the abuse of administrative power. It is meaningless and premature for China at this stage to discuss which means of securities regulation should be adopted since no regulation, disclosure regulation and merit regulation can always be interchangeable due to the abuse of administrative power. Even more unpredictable thing is that the policies of tightening regulation and loosening regulation could both be unenforceable as a result of the tug of war between the central and local governments or the relevant regulatory bodies and the securities industry. It is clear that a successful regulator must have in place lines of communication which build on trust and understanding rather than alienation and suspicion.

I, therefore, believe that irrespective of the contours of the system in place for Chinese securities market, the most important criterion impacting on ultimate success or failure is whether the various participants lend their support. Without receiving such approbation from affected constituencies, the road to success may be far too arduous. Enabling key players to provide input, engage in dialogue, and reach consensus will facilitate their acceptance of the system. By having a perceived stake in this framework, hopefully they will be more receptive to work toward its success. Thus, Chinese securities markets embark on a difficult journey which could need several generation’s effort. Persuading affected constituencies to embrace the framework adopted represents for Chinese securities markets a critical determinant.
Conclusion

The experiment currently underway in developing securities markets in China have met with initial success, although, as has been mentioned throughout this article, there are a considerable number of issues still to be addressed over time. Many of the issues will probably be resolved by trial and error as various participants in the market--the regulators, the exchanges, the intermediaries, the issuers and the investors--develop more experience. There is little doubt that in some instances the learning process will be painful--history tells us that all securities markets in the world have undergone such processes. Having said that, there is also little doubt that there is enormous potential for the growth of China’s securities markets.

Central to the problems of securities regulation in China are the issues of trust particularly between the markets and the state. Since China never developed a real political economy in the sense of openly acknowledging that political power might be harnessed to advance economic interests, those with interests that might be affected by governmental policies could not publicly call for allies or seek to mobilize opinion in favor of their interests. They could instead only try to operate quietly by seeking special favors in the implementation of policies, and thus risk being seen as a source of corruption.225 When the leaders identify the problems in the process of implementation,

225 For details, see Lucian W. Pye, The Spirit of Chinese Politics, Harvard University Press (1992), at 245. See also Harold D. Lasswell & Abraham Kaplan, Power and Society: A Framework for Political Inquiry, Yale University Press (1950), at 74-75. They argue that by conformity to or disregard of the policy, those whose acts are affected help determine whether it is or os not in fact a decision.
they would usually tighten the state’s penetration of local government’s affairs and the private rights of citizen. Thus, the rhythm of economic regulation in China is not the pendulum swings of left and right, of change versus continuity as it happens in the US; rather, it follows the up-and-down motions of centralizing which stifles local initiative, and decentralizing which produces chaos and detracts from pursuit of the national interest. Under the current political situation in China, it is very difficult for the regulators to establish workable lines of communication and understanding, both in the securities market and with the investing public, at large.

Chinese people, after many rounds of debate extending over more than a century, have come to realize the tremendous need for, and potential benefits from, building a strong country in favor of the western style democracy. But considering the rapid changes in the economic system and the Chinese society, I would venture to say that in the long run, nothing poses graver threat to the powers in Beijing than the forces of ownership reform already at work; the embrace of joint stock company and stock market has forever undermined the basic tenets of communism. The pace and uncertainty of this unique transition frighten as many Chinese as they embolden. Whatever the Chinese are on the way to becoming, the following counsel have to be offered: Naixin. Patience. Xuyao shijian. It takes time.
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