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www.emeraldinsight.com/2046-3162.htm

Received 18 March 2013
Revised 18 April 2013
1 May 2013
Accepted 2 May 2013

The state and the development of corporate insolvency law in China and Russia

A comparative perspective

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Abstract

Purpose – The purpose of this paper is to explore the origin of the development of insolvency laws in China and Russia and explores the evolving role of the states in the legislative process.
Design/methodology/approach – The study is conducted based on the analysis of historical materials and the relevant secondary sources written in Chinese and Russian.
Findings – The paper argues that the development of the insolvency laws in China and Russia underlines the diverging perceptions by the states about the ways to improve economic performance through reforming their respective state enterprise system. On the other hand, the unsatisfactory utilisation of the laws in the these countries revealed the incompleteness of the wider institutional reform that opened up possibilities for predatory exploitations and corruptive practices which in turn upset the market-building in these developing economies.
Originality value – This study highlights that by bring back the state into the analysis, the competing ideas, interests and institutions in the development of insolvency laws can be identified.

Keywords China, Insolvency law, Political economy, Russia

Paper type Research paper

Introduction

Corporate insolvency is no longer a novel phenomenon in developing economies. Their governments have realised the significance of the institutionalisation of creditor-debtor relations in facilitating market transitions through legal reforms. In particular, they believe that the development of insolvency laws[1] will be essential, not only forcing inefficient players to either upgrade or leave the economic scene but also disciplining market players. The purpose of this paper is to explain the significance of insolvency law in two developing countries, namely China and Russia, and the role of the states in its development. This paper addresses two specific research objectives. First, it attempts to trace and explain the development of insolvency laws in China and the Soviet Union (and later Russia) with reference to the role of the state. Second, it tries to highlight some key problems concerning the implementation of insolvency laws in these countries.

One of the key puzzles is why the discussion of insolvency laws took place in China and the Soviet Union when command economy continued to be the key institutional logic of their economic development. Indeed, it is easy to consider the creation of insolvency law in the socialist regimes as something redundant. It is pointed out that in a nationalised economy, the idea of creating proceedings for handling insolvent enterprises is unnecessary, for "both creditor and debtor enterprises were state-owned" (Stiefel, 2008, p. 283). At the structural level, the socialist states effectively monopolised all factors of production and performed all allocative and redistributive functions. The states supported the existence of the state-owned enterprises (SOEs) with a system of automatic lending, a practice that was not accompanied by any elaboration

Asian Education and Development Studies
Vol. 2 No. 3, 2013
pp. 212-224

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2046-3162
DOI 10.1108/AEDS-03-2013-0018

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of the responsibility for repayment. The paper is going to argue that the development of the insolvency laws in China and Russia underlines the diverging perceptions by the states about the ways to improve economic performance through reforming their respective state enterprise system. The other puzzle that this paper attempts to shed light on is the serious legal implementation gap. As shall be seen, the problem of the insolvency regime is not only about the technical inadequacies *per se*, but more importantly an array of predatory and corruptive practices which have pervaded their respective political economies.

This paper has the following structure. The first part of this paper provides a literature review of the key issues concerning the contemporary scholarship in the area of insolvency law. It also discusses the importance of the state in economic development and the possible theoretical connection between these three variables. The second part of this paper discusses the origin of the development of insolvency law in China and Russia and underlines the dynamics of interaction between insolvency laws, economic reform and the role of state enterprises. The third part of the paper discusses the problem of legal implementation gap in recent years.

The insolvency law, the state and economic development: a literature review

The legal development of insolvency laws in the common law jurisdiction has attracting substantial attention from the scholars of legal science. There are several overarching themes that can be identified. First is the distribution of debtors' asset (Oditah, 1992; Jackson, 2001). Because of the growing complexity of the credit facilities, the principle of equality in the distribution of the assets is becoming a more controversial issue. In English law, the creation of floating charge presents a very contentious instrument of pledge, because it could affect the distributional priority of different classes of creditors. The second theme concerns the control of fraudulent use of insolvency procedure and the possibility of voidable transactions. Keay (1998) argues that there is an urgent need in English law to review the notion of preferences when the creditors may use their exclusive information to strip off the assets of the debtors and upset the principle of fairness. Armour (2003), meanwhile, highlights the difficulties in ascertaining whether the transactions of an insolvent company are undervalued. Consequently, there is a need for insolvency practitioners to be more sensitive towards fraudulent practices that could affect the amount of assets for redistribution. The third theme concerns the development of cross-border insolvency procedure (Mason, 2008). With the globalisation of the economy, cross-border borrowing becomes more prevalent than ever before. The negotiation of cross-border protocol and the inter-jurisdictional cooperation of courts attract increasing attention from legal scholars. At the same time, the role of UNCITRAL in formulating the Modal Law on Cross-Border Insolvency reflects the growing importance of international agencies in setting legal standards (Halliday and Carruthers, 2009).

What is noticeable is, however, the lack of a multidisciplinary understanding of the origin of insolvency laws in the contemporary economy. Whilst most of the scholars and government officials agreed that insolvency law is important because of the growing importance of credit in supporting the continual development of capitalist economies (Cork, 1982), there has been a tendency for them to overlook the complexity involved in the law-making process involved:

> Bankruptcy law is very technical […] and partially in consequence of its technical complications, bankruptcy tends to be a politically neutral issue (until it is *applied* to

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> state-owned enterprises) [...] changing the bankruptcy law does not step on very many toes of substantial players in the present legal or economic structure [...] bankruptcy law can be revised without revising other bodies of law, and for the most part without creating new institutions to administer it (Bufford, 1996, p. 464, emphasis added).

Scholars from the emerging field of judiciary politics began to reject this position. Halliday and Carruthers (2009) in their evocative work examine the development of bankruptcy regimes in China, Indonesia and Korea. They argue that the convergence of the global and local forces gives rise to the divergent features in these jurisdictions. In addition, the substantial implementation gap suggests that we need to go back to "the state" in exploring the extent to which the international standard has been complied with (Halliday and Carruthers, 2009). Horton *et al.* (1996) argue that the development of the insolvency laws carries strong political weight and can be considered as a "test of fidelity to free-market economics" (Horton *et al.*, 1996, p. 16). Its development, accordingly, represents the making of an economic institution where the state is prepared to let those enterprises fail and to let market logic of competition govern partially the dynamics of production. In other words, the elimination of ineffective elements of an economy is no longer made by the state but by "the realities of the marketplace" (Horčicová *et al.*, 1992, p. 23). It is also an acid test which the financial institution, so created, to counterweight the predominance of those politically powerful groups in economic affairs (Horton *et al.*, 1996).

Hence, to capture the variations of the design and implementations of the insolvency laws, it is necessary for us to locate the role of the state in relation to economic development. There is a huge body of literature on this line of inquiry. North (1979), for example, highlights the importance of the state in providing the institutional basis for the enforcement of contracts and property right. The need for institutional stability thus becomes the key determinant of economic performance. Evans (1995) explores the very tension of the state in embedding itself whilst retaining its autonomy in achieving economic performance. The potentiality of being captured by vested interests is to be kept in check by the development of an array of institutions. Johnson (1982) argues powerfully that the developmental trajectories of national economies have been made possible by the close coalition between state agencies and business sectors. Despite its variegated roles, the state continues to be indispensable in creating an institutional basis for long-term growth.

In ensuring sustainable economic growth, the tension inherited in the institutional development is the extent to which politics should be separate from economics has been debated extensively (see Caporaso and Levine, 1992). Such separation is rooted in the neo-liberalist agenda which highlights the liberal orientation of the state in letting the market flourish on its own. Notably, it stresses the importance of law in protecting and regulating the private property right and contractual relations, but not further. However, having a good law does not mean that the state can divest itself of its responsibility. For instance, Glinavos (2008) warns that the obsession with the market-friendly development of law contains unintended effects, especially to the transitional polities when their constitutional settings are yet to be mature. Gilnavos (2010) also suggests that laws should not be used for the construction of a "minimal" state; instead, a more holistic understanding and application of laws is necessary for the "transitional" state to migrate towards a healthy market economy. In addition, Grzymala-Busse and Luong (2002) explore the difficulties in ensuring the state autonomy of the transitional economies, especially when the state ceased to be a unitary actor. The predatory competition amongst different actors can upset the efforts

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in developing a fair market. The pace, depth and scope of economic reforms thus become important in determining the balance between the state and the emerging market players. Hellman and Kaufmann (2001) also underscore the notable problem of state capture which suggests that the state can easily fall prey to the aggressive oligarchs if the former fails to uphold the legal integrity of its officials.

Socialist economy and the "oxymoronic" insolvency law: the origin of the insolvency laws in China and the Soviet Union

The comparison between China and Russia allows us to look at the difficult role of the state in their economic reforms. In particular, their similarities in historical-political context and their divergent paths of economic reforms have provided good cases to study how competing interests, ideas and institutions led to their distinct outcomes of the economic reforms. For instance, Nolan (1995) suggests that, as opposed to the Chinese gradualist approach, the orthodox view about economic reform stressing the importance of rapid reforms laid the foundation for the economic disaster in the immediate years of the dissolution of the USSR. Similarly, Kotz (2005) highlights a critical difference between the "hands-on" approach to reform adopted by China and the neoliberal-oriented shock therapy adopted by Russia which accounted for the relative stability of China's economic reform. The following empirical investigation suggests that whilst the emergence of insolvency law did, by and large, dovetail with the pattern of their economic reform, the presence of resistance and hesitation suggests that the re-negotiation between the state and the economy has to be scrutinised in a more nuanced way.

China

In China, the introduction of a new bankruptcy law in the early 1980s reflected the changing structure of the state in the context of its economic transformation and coincided with the growth of its inability to sustain the traditional pattern of state subsidisation. The lawmakers hoped to end the Chinese practice of "eating from the common pot" (*Liaowang*, 1986). Indeed, the lacklustre performance of SOEs has long been regarded as a burden for the Chinese Government because the majority of the former have relied heavily on loans and subsidies from the latter for subsistence.

Worthwhile to note also is that the development of the first bankruptcy law took place against the wider changes of political economy since the late 1970s. In the first place, the growing pragmatism among the party leaders led to the gradual decline of the traditional sanctity of ideological fundamentals associated with economic management (Tyson, 1988, p. H6). Such pragmatism emphasised the reasonable balance between growth and efficiency and the need for empirical experimentations to identify the best way out for the economic modernisation (Solinger, 1981). At the same time, the prospect for developing an institutional set-up that replaced "the particularistic bargaining" with "universally applicable rules" emerged as the key challenge for the overall economic reform of China (Clarke *et al.*, 2008, p. 378).

The development of the bankruptcy law reveals not only the problematic role of the SOEs as the market participants in this stage of their economic transition but the desirability of the decentralisation of the state control (Thomson, 1986). On 20 October 1984, the Chinese Communist Party passed the Decision of the Central Committee of the Communist Party of China on the Reform of the Economic Structure. This decision stated that to revitalise the socialist economy, the economic structure of China had to be reformed through the invigoration of SOEs and the development of a commodity

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economy (Chinese Communist Party, 1984). The main thrusts of the reform have been to eliminate economic losses arising from the over-centralisation of economic production and to encourage coordination and competition among enterprises. A high-sounding policy plea has been made to justify the introduction of the law. Zhang Yanning, the Deputy Minister of the State Economic Commission of China at that time, argued that the bankruptcy law was "very necessary" because those chronically ill companies in China were "inappropriate for the present economic reforms" (Thomson, 1986, p. 3).

The proposal of a new bankruptcy law created unprecedented uneasiness for the National People's Congress and some members displayed vehement oppositions (Tanner, 1999). Whilst some observers argued that the heated debate in the law-making process represented a triumph of "democratic participation" so as to minimise mistakes (Daohui, 1988, p. 90), what is more important is why the proposal itself triggered such a reaction. Apparently, the ideological hardliners were hesitant in accepting the proposal and perceived it as a signal of the declining importance of the socialist ideology in state development. Moreover, there was a deeper concern about the reformulation of the role of the state in guaranteeing the livelihood of workers' class and the shift of the responsibility to the management of enterprises. On top of that, the lawmakers refrained from advocating the law that would be considered as an abrogation of the responsibility of the state.

In view of the concern, it was emphasised that the form of bankruptcy law that was to be enacted in China shall "not be the same as the bankruptcy laws in capitalist countries" (Anonymous, 1986, non-paginated). In addition, the lawmakers advocated a more reconciliatory approach to the legislation (Li, 1984, p. 21; Tanner, 1999, p. 147). It follows that priority would be given to reconciliation over winding-up. Efforts were also made regarding the arrival of a consensus between creditors and SOEs through the restructuring of the latter (Li, 1984). After the legislative deliberation and compromises, the Enterprise Bankruptcy Law (for trial use) (1986 Bankruptcy Law) was finally adopted by the National People's Congress in 1986.

Since the mid-1980s, however, the Soviet state was experiencing an amalgamation of economic and fiscal constraints such as weak management and shortages of consumer goods which resulted in an irreversible downward movement (Denton, 1982). The state needed to search for various means to restore its economic productivity and minimise its expenditures. Restructuring its state enterprises became the most straightforward and viable way for the state to achieve the ends. With the Soviet state beginning to embark on the economic restructuring, the idea of bankruptcy finally appeared in the policy debate about the introduction of the USSR's Law on State Enterprise (Association) in 1987. The law articulated the need for the reorganisation of socialist enterprises in a competitive environment. More importantly, it was the first time that the Soviet state spelt out the possibility of the liquidation of enterprises and the possible dismissal of employees (Article 23). With the desire to further liberalise the economy, the Soviet lawmakers contemplated the development of a more coherent version of insolvency laws in 1990 (Campbell, 1994). Owing to the maddening scarcity of commodity which had already resulted in the abject impoverishment of the population (Strayer, 1998), the Super Soviet decided not to introduce such controversial legislation, the effect of which could accelerate the death of the Soviet state.

The dissolution of the USSR and the creation of the new Russian state entailed a new set of institutional challenges. Whilst there was an eagerness on the part of the

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Russian authority to embark on rapid economic transition through an array of neoliberal strategies, the prevalence of resistances should not be overlooked. To the new Russian state, it is not surprising that the need to pressurise the inefficient SOEs to accelerate their privatisation became the overriding rationale for the development of the first insolvency law in post-Soviet Russia (1992 Law "On Insolvency (Bankruptcy)") (Sonin and Zhuravskaya, 2000). Despite the unfavourable institutional setting, the imminence of the legislation can be justified on the ground that nearly 70 per cent of the SOEs in Russia were near bankruptcy (Anonymous, 1992a). In June 1992, because of the legislative-executive disagreement, the discussion of the insolvency bill was to be "put off indefinitely" (*Moscow Interfax*, 1992). Yeltsin, in response to the blockage by the Supreme Soviet, issued a decree which required enterprises to be declared bankrupt and auctioned if they failed to resume their service of debts within three months (*The Economist*, 1992). Five months later, the conservative-led Supreme Soviet finally passed the bill with the political compromise by the government to include bailout as the third way of dealing with insolvent enterprises (Rubinfien, 1993). The legislative saga reveals not only the growing uneasiness between the legislature and the executive in the immediate wake of the post-Soviet era but also the tenacious belief about the primacy of the state in economic management (Anonymous, 1992b).

The above discussion suggests that the development of insolvency laws in China and the Soviet Union coincided with the process of the re-negotiation of the relationship between the state and the economy. The reluctant attitude towards the legislation can be explained from the fact that the states were less able to maintain their centralised control of the economy. Allowing the enterprises to dissolve seemed to be a straightforward solution. However, the countervailing concern about the potential impacts on social stability explained the controversies during the legislative processes.

Equally important, the difference between the legislative outcome in China and that in Russia is for two reasons. First is their respective employment structure. According to Walder (1995), at the onset of their economic reform, 75 per cent of the employment in China was from the agricultural sector; and 75 per cent of the employment in Soviet Russia was from the industrial sector (p. 971). Accordingly, there was a higher prospect of re-employment in China than in Russia, especially when we consider the inflow of capital investment into China since the 1980s which generated more job opportunities in the industrial sectors (Walder, 1995). The danger of social instability arising from unemployment in China could still be kept within a reasonable scope. Regrettably, such an optimistic prospect was absent in Russia.

The second one is the underlying perception about the possible impacts of the laws on state enterprises. In China, the many barriers in applying to wind up an enterprise suggests that the real purpose of developing insolvency laws in China was not to encourage liquidation of the enterprises; rather, it is hoped that the laws can produce some positive effects on the production behaviour of the enterprises, thereby improving the overall economic performance. In contrast, the perennial problem of economic inefficiency had been closely related to the excessive number of enterprises in the Soviet economy, and only by closing down some of these enterprises might the economy have some chances to revive. It is thus possible to speculate that there was a substantial difference in the understanding of the laws, with China seeing it as a qualitative tool for improving industrial behaviours and Russia seeing it as a quantitative tool for eliminating excessive players.

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Gaps in the legal implementation of the insolvency law in China and Russia

China

Several technical and institutional constraints explain the underutilisation of the law. In the first place, by international standards, the first bankruptcy law is woefully inadequate and contains only 43 articles after the many legislative compromises. Its ambiguity has necessitated the supplementation of many judicial interpretations, rendering the legal structure of the insolvency regime fragmentary (Briscoe and Booth, 2009, p. 201). Equally important, the 1986 Bankruptcy Law cannot keep pace with the rapid economic changes that have happened since the 1980s. One of the principal challenges was establishing the legal status of private enterprises in 1988, because the 1986 Bankruptcy Law did not extend its power to the insolvency of non-SOEs. This defect was redressed by Chapter 19 of the PRC Civil Procedure Law, which provides for the procedures for dealing with the bankruptcy of non-SOEs with legal person status (Briscoe and Booth, 2009). To further address the omission of non-SOEs in the legal operation of the 1986 Bankruptcy Law, the People's Supreme Court has subsequently issued a series of interpretations. Nevertheless, this quilt of laws and judicial interpretations is so unconnected that it forestalls the meaningful and necessary exit of troubled enterprises (Harmer, 1996).

The 1986 Chinese Bankruptcy Law also did not live up to lawmakers' expectations in eliminating chronically indebted SOEs. Particularly, the operation of the bankruptcy law was hampered by extensive government intervention in judiciary processes and by the introduction of policy-mandated bankruptcy. The main reason for the surprisingly low number of bankruptcy cases since the promulgation of the 1986 Bankruptcy Law was the interference of local governments, which precluded the court's acceptance of bankruptcy petitions (Booth, 2008, pp. 284-285). Pursuant to Article 7, creditors may apply to the Court to declare the bankruptcy of the SOE in question provided that they can prove, to the satisfaction of the Court, the latter's inability to pay its debts. Article 8 provides that enterprises can apply to the law to declare bankruptcy on the condition that the approval of superior departments has been sought. This provision has left tremendous room for government interference, especially when the local government has expressed persistent concern regarding the potential effect that the massive dismissal of employees would have on social stability (Booth, 2008). All these explain why the first case where the ailing enterprise (Nanjing Chain Factory) went into liquidation took place only in 1992 (*Yangzhi Wanbao*, 2008). Before this, all cases had either received the loans and subsidies from the government or been ordered to undergo restructuring.

With the changing economic structure, the Chinese Party Government was awakened to the ample opportunities for manipulation in the bankruptcy procedures. In 2000, the People's Highest Court launched an investigation into a high-stake case of false bankruptcy of the Zhongjiang County Silk Company which involved collusion amongst the local cadres, the local government officials and the local court in pushing the enterprise concerned to bankruptcy (Fei, 2001). The investigation discovered a series of alarming irregularities, including the declaration of the bankruptcy of the enterprise without undergoing thorough investigation, non-notification of the creditors of the enterprise in accordance with the requirement of the law, and attaching unreasonable conditions to the auction of the assets of the enterprise (Fei, 2001).

At the same time, the Chinese Government has stepped up its effort to consolidate the judicial capacity in addressing the problem of corruption and strengthened the power of the Commission for Discipline Inspection. In 2006, two former senior

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presiding judges in the Shenzhen Intermediate People's Court were discovered by the Commission for Discipline Inspection to have been involved in appointing certain auction houses for liquidating the land property of debtors and were accused of receiving bribes arising from its sale (Tian and Long, 2006). Similarly, in 2008, a former judge of the Tianjin High People's Court was identified to have granted favouritism to a liquidation firm and an auction firm in exchange for bribes amounting to RMB910,000 (Fan, 2008, p. 3). In August 2010, Bengbu City Commission for Discipline Inspection and the Ministry of Supervision received public reports about the serious violation of discipline problems of the chairman and the managing director of the Huaihe Machine Enterprise (a SOE) and discovered the embezzlement of state property through the abuse of the bankruptcy procedure (Zhang and Qian, 2012).

But not all similar cases caught the attention of senior disciplinary authorities. It was reported that a collectively owned enterprise in Zaozhuang went into bankruptcy in 2000 engineered by the collusion between its management team and the cadres in the District Transport Department (Daoshen, 2012). The deeply agonised employees of this enterprise alleged that the land of the enterprise was sold just a month before the legal proceedings; the transaction was made at an undervalued price with the income shared among the local government and the senior management of the enterprise (Daoshen, 2012). They were also accused of having carved out the pension fund of the employees. Notwithstanding these apparent irregularities, the Court neither rescinded the transaction nor involved the employees in the proceedings (Daoshen, 2012). The administrators of the enterprise's asset – appointed by the local government but not by the Court – did not allow the participation of the employees in creditors' meetings (Daoshen, 2012).

Russia

Like in China, the initial development of the insolvency law in Russia was plagued by technical inadequacies and political problems. First, given the limited exposure to the market dynamics, most of the commercial laws enacted by the Supreme Soviet have suffered serious technical inadequacies and led to its under-utilisation. For instance, under the first insolvency law, creditors have found themselves in a very difficult position from which to prove the inability to pay debts and initiate the legal process (Radygin and Simachev, 2005, p. 7). On the other hand, the effectiveness of insolvency regimes has been persistently frustrated by the problem of corruption, the arbitrary nature of governmental agents at the regional level of enforcement and the incompleteness of economic reform (OECD, 2005; Kratzke, 2000). For instance, the 1992 Bankruptcy Law failed to achieve the goal of pushing privatisation ahead precisely because of the collusion among the enterprise managers of the SOEs and the regional leaders with vested interests (Sonin and Zhuravskaya, 2000). These actors managed to escape the pressure by manipulating the balance-sheet values of the enterprises, rendering the piece of legislation no more than a paper tiger (Sonin and Zhuravskaya, 2000).

In addition, the insolvency procedure has been widely manipulated as a deliberate tool for forceful seizures of property and other predatory commercial activities, such as hostile take-overs (Slepyshev, 2010). The new law was not able to deter fraudulent or crime-related bankruptcy from taking place (Radygin and Simachev, 2005). Accordingly, one-fifth of the cases under investigation in 2000 were considered to be of a criminal nature (Radygin and Simachev, 2005 pp. 49-50). All these destabilising irregularities can be attributed less to the underdevelopment of the judiciary system

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and more to avaricious oligarchs and local governors who "have learned how to use such laws to seize not only struggling businesses but also what in other societies would be considered healthy and even profitable enterprises" (Goldman, 2003, p. 32).

The chicanery associated with the use of insolvency law has been made possible by the collusion amongst courts, political elites and of course businessmen. Tyumen Oil was considered to be one of the notorious uses of the insolvency law in taking over its enemies or other business interests (Goldman, 2003). The company had a long interest in taking over Chernogorneft (owned by Sidanko Oil Company) whose oil fields happened to be next to the ones owned by the former. In 1998, the judge, appointed by the regional Governor Leonid Roketsky who happened to be the Chairman of Tyumen Oil, declared Chernogorneft bankrupt after a series of insignificant creditors' lawsuits (Semenenko, 1999). The subsequent legal proceedings were largely controlled by the connivance of Governor Roketsky and his judges; and whilst Sidanko was working out settlements with different creditors, Tyumen already started acquiring Chernogorneft's properties at an undervalued price with courts' approval (Goldman, 2003). These transactions by their nature constituted an act of fraudulent conveyance and it was uncertain why the court could have approved the transaction other than the reason of corruption (Kratzke, 2000).

The relevance of the insolvency law in the Russian economic reform has also been limited by its growing devious uses by the government that frustrate the purpose in establishing a new economic order. In February 2000, the Amendment to the 1998 Bankruptcy Law was adopted at the State Duma. One of its provisions is that tax agencies and other key government agencies be allowed to vote at the creditors' meeting. Immediately, worries were expressed that such a provision would be manipulated by the state to achieve political goals (Sonin and Zhuravskaya, 2000). These worries turned out to be legitimate, with more than 90 per cent of the bankruptcy applications in 2002 filed by the state authorities, particularly tax authorities who saw them as a quicker means of tax collection (Radygin and Simachev, 2005, p. 50). The legislator, however, considered such tendencies as less problematic and more of a logical outcome. In the legislative process for the 2002 Bankruptcy Law, the government reiterated the need to strengthen the insolvency regime's ability to protect the state as a creditor and indicated that the state should be accorded a greater voice in the arbitration process (State Duma Committee on Property, 2002). All these have created an impression that Russia's insolvency regime has been increasingly used to achieve individual ends, and this regrettable trend contravenes the basic purpose of an insolvency regime, i.e. to develop an effective and fair channel through which to facilitate the systematic exit of troubled enterprises.

Worse still, the complicity of the state in manipulating the insolvency law to serve the purpose of expropriation speaks of its latent predatory disposition. The most salient example of this is the notorious Yukos affair in which the state seized the control of the assets of the Yukos Oil Company by forcing it into financial difficulties through filing a series of bankruptcy claims within a short space of time. One commentary suggested that the Yukos affair has decimated the very prospect of the nourishment of a new business culture based on corporate governance and transparency while perpetuating the tendency of "shadowy state control" (Osborne, 2011). Tompson (2010. p. 74) even concludes that the bankruptcy of the company represents the "most crudely engineered instance of re-nationalisation to date".

The above discussion suggested that whilst the problem of technical efficiencies may discourage the creditors to use the laws to realise their legitimate interest, what is

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more problematic is the twin problems of state intervention and judicial corruption which upset the principle of fairness in the insolvency procedures. Worse still, in the case of Russia, the problem of the state manipulating insolvency procedures to its own advantage has upset the fundamental market discipline which has always been fragile in Russia.

Conclusion

In conclusion, the development of insolvency laws in China and Russia represented an episode when the state was caught in a dilemma to ensure social stability and economic performance at the same time. The development of insolvency laws also represents a process where the re-negotiation between the state and the enterprises became inevitable in the light of the economic reforms in China and Russia. What is important is, however, the difference in the states' framing about the underperformance of state enterprises in such a process. At the time of the introduction of the laws, the Chinese states believed that the problem was a remediable one provided that the enterprises could adopt a more efficient managerial approach to upgrade their productivity. In contrast, the Russian state believed that the problem of state enterprises was a quantitative one; the inevitable appearance of the insolvency bills in the late 1980s suggested that instead of asking them to reform further, such an imminent problem had to be addressed by eliminating some of these enterprises.

The study also suggests that the problem with the insolvency law in transitional economies is not only about the design *per se*, but also it is the institutional set-up that has limited its applicability and relevance. Whilst it is apparent that both China and Russia wanted to relieve themselves of the burden of subsidising the debt-incurring SOEs, the predatory use of insolvency law has not been rare. The problem of judicial corruption and arbitrariness in insolvency proceedings has also lent support to the dominance of business malpractices rather than creating a platform for enforcing and institutionalising market discipline. Without the development of a "thick" legal system, it is likely that these irregularities may persist.

Note

1. The terms of "bankruptcy" and "insolvency" are used interchangeably in this paper.

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