
Abstract

Changes in Chinese Legal System and its Impact on Korean Firms

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China is the destination of nearly 25 percent of all Korean exports and a major source of investment. The two countries enjoy a reciprocal economic relationship; Korea is China's third-largest trading partner overall and fourth-largest investor. Trade with China is of substantial importance to the Korean economy, as volumes between the two nations handily outpace those between Korea and the U.S. and Japan combined. It is thus plainly necessary to study and grasp changes in the Chinese economy and industrial landscape, for any effects produced by such changes are certain to bear influence on the Korean economy.

This paper surveys and analyzes the changes in Chinese law, institutions and national policy as they affect Korean firms currently doing business on the mainland and firms hoping to expand operations there in the future. It also studies the nature of the effects these

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changes have on Korean firms hoping to enter the Chinese market.

This study asks the following questions. First, why do we need to study Chinese law and ascertain its peculiarities? Second, what is the nature of the more recent changes in that country's laws? Third, what are the effects of these changes on private enterprise? And how should governments and private industry respond?

Chapter 2 comprises an examination of the significance of the analytical results and describes their salient characteristics of Chinese legal environment. The Chinese legal system is of the Continental style and thus shares broad similarities with the system in Korea, but the way in which the law is actually applied results in many notable differences. Since China has the Legislative Law, general laws, administrative regulations and sectoral regulations clearly defined. The Communist Party is at the forefront of any and all national policy initiatives, leading any nationwide economic changes or transformations from the top down.

Foreign direct investment by Korean firms in China grew at a break-neck pace after the two countries established formal diplomatic relations, and in 2007 China-bound investment by Korean firms totaled 5.7 billion USD, with Korean firms having established production base on the country's eastern seaboard owing to the low cost of land and labor in that region. Korean investment in China fell following the crises that gripped the global economy from the latter half of 2007 into 2009, but as conditions improved outbound flows quickly recovered.

The sovereignty dispute between China and Japan over the Senkaku islands exerted a chilling effect on bilateral economic activity near the end of 2012. Korean firms took advantage of the vacuum and poured

5.2 billion USD into Chinese operations in 2013. But investment again fell again from 2014 to 2016 as shale gas flooded the market, ushering in a period of low oil prices and slackening demand.

Then the THAAD dispute came to a head in 2016, during which some Chinese consumers began demonstrating open hostility toward Korean products. This, along with rising wages, the strengthening of regulations designed to protect the environment and new industrial safety measures have combined to raise production costs considerably and have depressed investment. The majority of Korean firms are now moving their production processes abroad to nearby countries including Vietnam and Indonesia.

Chapter 3 explores recent trends and changes in the Chinese legal system, concentrating its analysis on revisions and additions made within the past five years. The analysis will focus on economic laws and regulations that should be of particular interest to Korea firms entering the Chinese market. It examines foreign investment law and policies, antitrust law and standardization laws and policies, as well as environmental law through an analysis of the Environmental Protection Act and labor law in an examination of the Labor Contract Act. It also addresses intellectual property issues in looking at the Patent Act, the Copyright Act, the Trademark Act, the Cybersecurity Law and the Electronic Commerce Act.

Chapter 4 outlines the results of a fact-finding survey conducted for the purpose of this study. The survey sought to grasp the scope and breadth of the effects recent changes in Chinese law have had on Korean firms operating in China. Face-to-face interviews were conducted as part of the survey methodology, and through them direct

knowledge of how exactly recent changes in Chinese laws have affected Korean firms (and the nature of the countermeasures those firms have deployed) was ascertained.

The survey results indicated that the environmental, labor and foreign investment laws have the biggest impact on Korean firms' Chinese operations, and that the negative effects of these changes largely outweighed the positives. Of the firms surveyed, 45.6 percent (98 companies) reported that they had acquiesced to the demands of the Chinese government in accordance with changes in Chinese law, while 36.7 percent of firms did not respond to the question. In fact, there is no other countermeasure except for compliance.

Interviewees expressed that their operations were particularly sensitive to changes in environmental law, fire and safety regulations and labor law, in that order. For companies, the any effect that might result in a cessation of production was deemed of weightier consequence, and for firms that have no choice but to emit pollutants as part of their manufacturing process, temporarily halting operations to comply with environmental inspectors was particularly detrimental. Through the interviews it was also ascertained that while changes in labor law have results in increased labor costs, these increases did not precede government-mandated shutdowns.

In the fifth chapter, the impact of legal changes on was analyzed by industry. The degree to which businesses are affected by changes in the law depends on a number of factors, of which business type is only one. Size, growth potential, whether or not a firm is possesses technology and the relationship of a firm with its parent company all influenced the ultimate degree by which firms were effected by changes in

the law.

The survey results indicate that changes to environmental and labor law had the greatest effect on businesses, and some firms felt these changes to a comparatively greater extent. Materials fabricators were particularly sensitive to changes in environmental law for example, while businesses in the IT sector were greatly impacted by changes in labor law. This owes to the fact that the materials business such as a chemical industry is a major contributor to environmental problems and thus a prime target for environmental regulation, changes to which will quickly make themselves known in the industry. And the IT industry, which employs a great number of people in process assembly work and also a large number of workers with specialized skillsets, is disproportionately impacted in changes to laws dealing with hiring and firing and is also sensitive to wage increases wrought by legal changes.

In-person interviews performed as part of the survey help complete the picture. Among manufacturing concerns, respondents said changes were most deeply felt in laws related to the environment, labor, fire and safety. The impact of legal revisions on the machinery industry was especially notable. Machinery concerns require a large workforce, making them sensitive to changes in labor law, and they also produce wastewater and emit noise and air pollution, practices affected by changes in environmental law. The IT industry, due to the nature of its employment structure and production processes, is susceptible to changes in labor law but comparatively unruffled by changes in environmental law. The materials industry is significantly affected by changes in environmental and safety law, as it produces and stores highly volatile materials with a large environmental footprint, but is

not as severely affected by changes in labor law owing to its highly-specialized labor force and comparative difficulty in recruiting that specialized talent.

An analysis of firms sorted by corporate characteristics showed that major enterprises - global conglomerates and multinationals - were less affected by changes in laws and regulations and more readily complied with the host country's laws and systems. For small to medium-sized firms competitive in terms of quality and technology, legal changes often result in cost increases; they are responding by improving internal competitiveness and honing a competitive edge through further improvements to technological sophistication, quality control and production efficiency.

Chapter 6 describes the nature of the corporate response to legal changes, and the direction that government support for these firms is taking. For companies, it is essential to continuously study and maintain a grasp on the constantly changing political and legal climate. Complying with new laws and regulations while meeting rising costs, finding new markets and exploring new business ideas will require no insignificant amount of effort by companies. In order to continue generating profits in China, improving quality and deploying advanced technologies as part of a greater effort to enhance corporate competitiveness is non-negotiable. And as it appears as the business of processing trade, currently the dominant pattern in China, has a limited lifespan. It follows that efforts must be made to secure new business models of profit generation. Considering that the Chinese market is still rapidly growing, and that 14 percent of all consumption occurs in online space, it makes sense for companies to take a hard look at

entering the domestic market through online transaction.

As for the government and the public sector, efforts to provide a variety of business models are necessary. Among these, a model for building a real estate platform is of particular need. In addition, it is necessary to review the use of the Variable Interest Entity (VIE) model, which is useful to enter the restricted industry in China. As the business environment in China continues to undergo a rapid transformation, Korean firms need to explore alternatives to the processing trade model that characterizes the extant paradigm and develop a business model based on industrial investment. It is also critical for the government to provide Korean companies entering the Chinese market with accurate information on recent changes in the Chinese legal and political system.