Analysis of the Application of Bankruptcy to Rural Collective Economic Organizations in China

Yu She
School of Chengdu University of Technology, Chengdu, China

Abstract

Rural collective economic organizations are special products of China's rural land collective ownership system. Since their creation, they have been playing the functions of fulfilling the state's political functions, serving farmers' public causes, and promoting rural economic benefits, but their legal attributes and institutional construction have been in an incomplete state. In recent years, the state has been pushing forward the legislation on rural collective economic organizations, and the participation of rural collective economic organizations in market economic activities as special legal persons has been recognized by law. Market entities participating in economic activities will inevitably fall into debt difficulties and be unable to pay them off. In the context of the legislation on rural collective economic organizations, the study of their bankruptcy application is not only a supplement to the integrity of the legislation but also a response to the needs of practice and reality. In this paper, we will analyze the bankruptcy capacity of rural collective economic organizations and propose the design of bankruptcy procedures that are in line with the corresponding national conditions in rural China, starting from the special characteristics of rural collective economic organizations in China.

Keywords
Rural Collective Economic Organization; Bankruptcy; Special Legal Person; Market Exit.

1. Introduction

The Civil Code of the People’s Republic of China promulgated in 2021 specifies the legal attributes of rural collective economic organizations as special legal persons and gives them the status of legal persons. In 2022, the Constitution and Law Committee of the National People's Congress issued a legislative plan for the Law on Rural Collective Economic Organizations. Therefore, in the current context of China's vigorous promotion of The Rural Revitalization Strategy, the reform of the rural collective property rights system, the revitalization of rural collective assets, and the development of the rural collective economy, it is of great significance to study the corresponding system that matches the construction of the rule of law of rural collective property rights. At present, rural collective economic organizations have been involved in market economic activities as market subjects, and the so-called "survival of the fittest" will inevitably lead to business failure and debt crisis of rural collective economic organizations. Therefore, against the background of the urgent need for legislation on rural collective economic organizations, the study of the termination of their legal persons and the construction of a framework for the application of bankruptcy procedures will, on the one hand, promote the framework logic of the legislative work in theory and, on the other hand, maintain the fairness and justice of the market in practice, promote the real marketization of rural collective organizations, and avoid major systemic risks.
2. The Basis of Exploration: The Special Characteristics of Rural Collective Economic Organizations

Before discussing the application of bankruptcy to rural collective economic organizations, we need to understand the special characteristics of rural collective economic organizations and focus on clarifying the obstacles of their particularity to the application of bankruptcy procedures to rural collective economic organizations. In general, it is believed that the special characteristics of rural collective economic organizations are the duality nature of their functions, the special nature of their property, and the community and closed nature of their members, among which the bankruptcy ability of rural collective economic organizations is mainly the duality of their functions and the special nature of their property, which will be discussed in detail below [1].

2.1. The Duality of the Blending of Functions Arising from the Development of Historical Practice

China’s rural collective economic organizations are the product of the evolution of the land reform law in New China and the evolution of China’s rural collective economic organizations from primary agricultural production cooperatives, and advanced agricultural cooperatives to people's communes. During this period, rural collective economic organizations were not only burdened with the functions of rural economic construction and economic benefits of rural assets but also with the functions of public services such as rural infrastructure construction, management of collective assets, and social security of members. Therefore, many theories believe that rural collective economic organizations have been "politically oriented" since their establishment, and they have assumed many public functions and social services. If the rural collective economic organizations go bankrupt, the expenditure required for rural public activities will not be borne, and the development of agriculture and rural areas is bound to be seriously affected. The interests of farmers will not be fully protected.

We believe that the priority of rural collective economic organizations should focus on the development of the collective economy, which can fundamentally guarantee the development of agriculture, rural areas, and individual farmers. As the relevant policy documents in recent years mentioned, "to carry out the implementation of the 'separation of government and economy' experiment," "clarify collective economic organizations market subject status, improve the rural grassroots Party-led villager self-governance organizations and collective economic organizations and so forth [1]. With the reform and development, rural collective economic organizations will continue to divest themselves of their public and political attributes and participate in the market economy.

2.2. The Specificity of Property Division Arising from Rural Collective Property Rights

In legislation and practice, the assets of rural collective economic organizations are often classified as resource assets, operating assets, and non-operating assets. Specifically, resource assets refer to the assets owned by rural collectives as specified in the Constitution, i.e., land, forests, mountains, grasslands, wastelands, mudflats, etc.; non-operating assets specifically signify assets with public welfare attributes such as educational, technological, cultural, sanitary, athletic, etc., which are used by collectives for public services; and operating assets indicate those that do not have public welfare attributes and are used in collective economic organizations for production and operation and for civil and commercial activities. The operating assets are the main properties that do not have public welfare attributes, such as collective enterprises, plants, machinery and equipment, agricultural infrastructure, etc. Based on this characteristic, some scholars argue that allowing rural collective economic organizations to go bankrupt means that assets such as rural land may flow to private subjects,
which may impact the collective ownership system established by the Constitution and undermine the development of the socialist public ownership system.

We believe that the above view is not correct. First of all, we need to clarify the positioning and nature of the rural collective economic organization. The rural collective economic organization has the authority to exercise the right to manage and operate the assets collectively owned by the farmers in the organization, they are managers and operators of the rural collective assets and economy, not the owner of the rural collective assets. Therefore, according to the Constitution, rural land belongs to the rural collective, and the bankruptcy of a rural collective economic organization does not lead to the entry into bankruptcy of resource assets and non-operating assets that do not belong to its corporate assets and are used to settle debts. On the contrary, for operating assets, because they are negotiable and can be quantified in the form of shares or stocks, in practice, many peasant collectives, through democratic resolutions of members, carry out reform of collective property rights system, transfer collective business assets to rural collective economic organizations to become legal person property and quantify them into members' rights and interests in the form of shares. Thus, the property of rural collective economic organizations is mainly the operating assets of collective assets, excluding resource assets and non-operating assets. Therefore, allowing rural collective economic organizations to go bankrupt does not violate the collective ownership of rural land, but on the contrary, it will promote the establishment of a rural economic credit system and revitalize the use of rural collective land.

3. Logical Evidence: Analysis of the Application of Insolvency Procedures to Rural Collective Economic Organizations

3.1. Strategically in Line with the National Reform of the Rural Collective Property Rights System

The Central Committee of the China Communist Party has repeatedly proposed to "deepen the reform of rural collective property rights system" and "promote the modernization of national governance system and governance capacity." The construction of rural collective economic organizations is an important part of the reform of the collective property rights system and an important way to improve rural governance capacity and promote the construction of grassroots organizations in China.

As mentioned above, in current practice, rural collective economic organizations and villagers' committees have a mixed composition of personnel, operation mechanism, and organizational functions, and a state of "political and economic unity." Clarify the status of rural collective economic organizations as market entities, allow them to apply bankruptcy procedures, and return to economic functions not only the future policy direction and reform trend but also the proper meaning of the system of rural collective economic organizations, which is in line with the national policy of implementing the 'separation of government and economy' experiment. Since rural collective economic organizations are to become real market subjects, they are bound to fall into crisis and come to an end one day as market subjects. The establishment of a bankruptcy system for rural collective economic organizations is not only a perfection of the supporting system for entering the market but also has the function of reducing risks and transaction costs and fairly protecting claims, thus promoting the participation of rural collective economic organizations in the market economy.

On the other hand, the reform of the "three rights (ownership, contract and use) of rural land" is currently in full swing in rural areas, and the key to the "three rights of land" is to "revitalize the use rights." As mentioned above, the right to use collective operating construction land, the right to use flexibly used land in agricultural land, the right to operate land in the "four wastelands," and the income from the land operated by the collective are all operating assets of
the rural collective economic organizations, which become the legal assets of collective economic organizations, and realize moderate scale operation through the concentration of land management rights [2]. Thus, we can prove that the orderly transfer of land management rights has been supported and permitted at the legal and policy levels, and its inclusion in the bankruptcy property is in parallel with the basic spirit of transfer. Allowing the operational assets of rural collective economic organizations to enter the bankruptcy procedure as bankruptcy estates is precisely the "revitalization of management rights" to adapt to the reform of the rural collective property rights system. However, it should be noted that even if land management rights are allowed to become bankruptcy property, we should always adhere to the principle of agricultural land use and arable land protection, i.e., the basic nature and basic use of agricultural land should not be changed, which means that creditors who acquire bankruptcy property should still maintain the agricultural use of the land and not use it for other commercial purposes.

3.2. Conceptually Consistent with the Core Values of a Modern Bankruptcy System

The first bankruptcy system can be found in the ancient Roman law, The Law of the Twelve Bronze Tables, where it is written that if a debtor fails to pay his debts as they fall due. The debtor will be handed over to the creditor for personal servitude if the debtor does not execute the judgment for 30 days; after 60 days, the creditor has the right to execute the debtor or sell the debtor to the slave market. The function and value of the early bankruptcy system can be described as disciplinary and punitive, even if later, with the creation of the corporate and company system, the value and function remain unchanged when the personal bankruptcy system developed into the corporate bankruptcy system. At this time, the bankruptcy procedure was a bankruptcy liquidation procedure, a procedure in which the entire property of the debtor was used to pay all creditors fairly, in which creditors were qualified to participate in the liquidation of the entire property of the debtor, and their claims were paid fairly, while the company was punished in the form of "closing down" [3].

However, with the development and progress of society, the value of bankruptcy law has changed from creditor-based to the balance of interests of creditors and debtors, and then to social interest-based. The bankruptcy function under the social interest orientation has fundamentally changed, and it is no longer focused on the discharge of claims and the discipline of debtors but embedded with a rescue culture. The bankruptcy reorganization system was established in the U.S. Bankruptcy Law in 1938, and after the 1970s, countries around the world reformed their bankruptcy laws. In the tide of reform, the bankruptcy laws of civil law countries were profoundly influenced by debtor regenerationism, and the legislative amendments also introduced bankruptcy reorganization procedures. By the 1990s, the focus of corporate insolvency law further shifted to the rescue of troubled enterprises.

Just as a funeral parlor does not produce death, bankruptcy law itself does not produce bankruptcy. The rescue philosophy of modern bankruptcy law has gradually taken root. In bankruptcy practice, pre-reorganization and sale reorganization have gradually developed, all aimed at saving the debtor and the debtor’s business, and a number of examples of successful rescue have emerged. Therefore, allowing rural collective economic organizations to apply bankruptcy procedures does not mean that some rural collective economic organizations that may be in a debt crisis and in trouble are pushed into the abyss. In contrast, allowing rural collective economic organizations to apply the bankruptcy system will give them an additional path to choose and an additional hope to get out of their difficulties. The bankruptcy system can build a platform for distressed rural collective economic organizations to negotiate with debtors to clear their debts, recruit investors to revitalize their assets, and to a certain extent,
legally forgive debts that cannot be discharged, which is the embodiment of the modern bankruptcy system’s rescue culture to serve the interests of society.

3.3. Logically in Line With the Body of the Civil Code and Collective Economic Organization Legislation

Since China’s reform and opening up, rural collective economic organizations have been playing a role as a class of important civil subjects on the Chinese land. Although the subject status of rural collective economic organizations is clearly stipulated in the Constitution, there is a lack of research in both the academic and practical world on the organic law of what collective economic organizations are and how they should be governed.

Until the introduction of the Civil Code, the provisions of Article 96 of Chapter 3, "Legal Persons," specify that rural collective economic organizations are special legal persons. Therefore, based on the position of rural collective economic organizations in the Civil Code, we think it is logically easy to conclude that rural collective economic organizations can be terminated and use bankruptcy: the stipulation that rural collective economic organizations as a special legal person is provided for in Chapter 3 of the Civil Code under the title of "Legal Persons", and the logic of the applicable law should follow the general provisions on legal persons under Chapter 3, Section 1 of the Civil Code. In this case, according to Article 68 of the Civil Code, a rural collective economic organization as a legal person may be terminated under certain conditions and may be terminated through bankruptcy in accordance with the second paragraph of Article 68. Therefore, if a rural collective economic organization cannot be subject to bankruptcy proceedings, logically it may be suspected of violating the legal person system of the Civil Code. In addition, theoretically, as a social organization, a legal person enjoys civil rights and capacity, so it naturally has the initial establishment, further development, and final extinction. If a rural collective economic organization cannot be subject to the bankruptcy procedure, theoretically, it may be contrary to the special legal personality stipulated in the Civil Code.

In 2022, the Constitution and Law Committee of the National People’s Congress clarified the legislative plan of the rural collective economic organization law, and both the leading group and the working group for drafting the rural collective economic organization law have been established, and the related work has been started. Since the legislation for rural collective economic organizations is to be introduced, the termination system is an important part of the construction of rural collective economic organizations, and it is also an issue that the legislation should focus on. In group law, termination is an inevitable part of group operation. Just like the birth and death of a natural person, the termination of a group represents the destruction of the group’s personality and no longer has the capacity of rights in civil law. Following this logic, as a special legal person and a group in civil law, the termination of a rural collective economic organization should also exist. In the process of legislation on rural collective economic organizations, if we avoid discussing or setting up a section on the termination of the organization, it may disobey the integrity and continuity of the law on rural collective economic organizations from the perspective of the logic of legislation.

3.4. In Practice, It Meets the Development Needs of the Rural Collective Economy

Nationwide, rural collective economic organizations generally have a high level of debt and heavy burden. According to the data of relevant survey institutions, the average asset-liability ratio of rural collective economic organizations nationwide was 61.58% as of 2018. According to the general principles of economics, it is considered appropriate for the asset-liability ratio of a subject to be between 40% and 60%, while an asset-liability ratio greater than 60% means that the subject is facing high financial risks, and 70% is the internationally recognized alert
line for asset-liability ratio [4]. In enterprise bankruptcy, the gearing ratio is a common criterion to measure whether an enterprise is insolvent or not, and an excessive gearing ratio may lead to the continuous deterioration of the subject’s business condition and eventually to insolvency. Based on the above asset-liability ratio data, it can be seen that, from a national perspective, the asset-liability ratio of rural collective economic organizations is relatively high, and there are financial risks.

Looking at the average financial situation of rural collective economic organizations nationwide, rural collective economic organizations have heavy debts, certain operational risks, and relatively high bankruptcy risks. Allowing rural collective property rights to go bankrupt is a response to the need for practice and reality to put legislation in the forefront to better protect the rural collective economy. Bankruptcy can provide a market clearing mechanism for rural collective economic organizations, following the law of the survival of the fittest in the market. And organizations that are poorly run, insolvent and have no development value should be withdrawn from the market and handed over to more efficient organizations for management. We believe that the reform of the economic system must focus on improving the property rights system and market-oriented allocation of factors to break the "state underwriting" inertia of thinking firmly. If the bubble bursts after the accumulation and spreads, do research then it will be too late.

We believe that the participation of market players in economic activities is bound to be terminated one day, and the business risks faced by rural collective economic organizations participating in market activities will not be avoided because of the composite nature of their functions and the special nature of their properties, which may also fall into a debt crisis and need to clear their debts and obtain regeneration with the help of bankruptcy system. At the same time, giving rural collective economic organizations the ability to go bankrupt balances the interests of creditors, rural collective economic organizations, farmers’ collectives, and society. From the perspective of debtors, granting rural collective economic organizations bankruptcy capacity may have the effect of reducing transaction risks and transaction costs; from the perspective of rural collectives and rural collective economic organizations, granting rural organizations bankruptcy capacity is conducive to improving their awareness and ability of risk prevention, avoiding opportunistic and other risky behaviors, promoting the establishment of their credit system, and ultimately maximizing social interests.

4. **Institutional Concept: Design of Insolvency Procedures for Rural Collective Economic Organizations**

Enterprise Bankruptcy Law of the People’s Republic of China stipulates that the bankruptcy liquidation of organizations other than enterprise legal persons may also apply to the law, the bankruptcy of rural collective economic organizations is different from the bankruptcy of general enterprise legal persons, and we believe that rural collective economic organizations are not suitable for direct application of the Enterprise Bankruptcy Law at this stage. It is necessary to transform the existing bankruptcy system for enterprise legal persons and build a bankruptcy system that can not only standardize the bankruptcy procedures of rural collective economic organizations but also take into account their particularities.

Through the analysis and research of the foreign bankruptcy system, we believe that the framework of the bankruptcy system of the rural collective economy at the present stage can be borrowed from the U.S. municipal bankruptcy system and the French bankruptcy conciliation pre-procedure system, which will be described in detail below. We need to emphasize that we do not think that there is no possibility of applying the Enterprise Bankruptcy Law to the rural collective economy, but under the background of the current transitional period of rural collective property rights system reform and the first legislation of
rural collective economy, the functions and properties of rural collective economic organizations have not yet been fully clarified, so we can encourage and guide the application of bankruptcy reorganization and reconciliation system as a priority, and apply bankruptcy liquidation procedures afterward. However, with the deepening of the reform of the collective property rights system, when the rural collective economic organizations have been completely stripped of their public functions and become real economic organizations in the future, it is inappropriate to adopt the extraterritorial municipal bankruptcy system and bankruptcy conciliation pre-procedure system, etc.

4.1. Drawing on the U.S. Municipal Bankruptcy System

The U.S. Federal Bankruptcy Act of 1898 added a municipal bankruptcy relief process. The main feature of the U.S. municipal bankruptcy system is that the procedure does not aim at eliminating the qualification of local government subjects but puts debt restructuring in the first place to solve the local government debt crisis. The U.S. municipal bankruptcy system has played an important role in solving the local government debt crisis and ensuring the orderly and stable development of the U.S. economy [5]. It not only protects the interests of creditors in a fair manner but also forces the government to be accountable to itself, regulates government financial behavior, and improves government management, thus ensuring the performance of local government public service functions and avoiding social order-disorder. The setting of bankruptcy procedures for Chinese rural collective economic organizations can be borrowed from the U.S. municipal bankruptcy system, which can not only liquidate debts when they are insolvent and unable to pay off all debts due but also avoid the elimination of the main qualification of rural collective economic organizations due to bankruptcy procedures, and also help promote the standardized operation of rural collective economic organizations, which also coincides with the spirit of the reform of the rural collective property rights system conducted at present.

Apparently, for borrowing from the U.S. municipal bankruptcy system, it is necessary to make appropriate adjustments and reasonable rule design according to China’s legal system and the current situation of rural economic development so as to avoid situations of unconformity. Specifically, it should include the following aspects. First, the power of the U.S. courts in municipal bankruptcy is greatly restricted, and they play a negative role, which is the opposite of the arrangement of the Chinese bankruptcy system. In China, the court plays an important role as the controller of the proceedings and the defender of the public interest, and its dominant position is maintained throughout the bankruptcy case. According to the relevant provisions of the Summaries of the National Conference for Work of Courts on the Trial of Civil and Commercial Cases in China, "if social stability may be affected, coordination between the government and the court shall be strengthened, and corresponding plans shall be formulated." And in practice, a joint working mechanism between the government and the court is often established for enterprise bankruptcy cases that significantly involve social stability, so as to advance the bankruptcy proceedings and safeguard social interests. Simultaneously, because of China’s vast territory, different levels of regional economic development, and different levels of legal construction, the leading role of the courts should be given full play in the bankruptcy reorganization of rural collective economic organizations, rather than the main the right to direct is given to the rural collective economic organization as the debtor. Secondly, U.S. municipalities, as debtors, are given greater authority in municipal bankruptcy proceedings. For example, Only the municipalities can propose reorganization plans, but their rights as debtors should be moderately limited for rural collective economic organizations. In China's bankruptcy law, the court has the authority to appoint an administrator, and if the administrator is responsible for managing the property and business affairs in a bankruptcy reorganization, the administrator should produce a draft reorganization plan. In practice, the
administrator is often a law firm, accounting firm or bankruptcy liquidation firm, which has a higher level of professionalism than the debtor rural collective economic organization. Therefore, in our country, the administrator should also be given the right to formulate the draft plan for the reorganization of rural collective economic organizations. It can avoid the imbalance between the rights of creditors and debtors in the restructuring of rural collective economic organizations, make use of the professional administrator's ability to formulate a more scientific restructuring plan, and also play the leading role of the court in the formulation of the restructuring plan. Finally, the legal consequences of bankruptcy restructuring can be added. Based on the inevitability of the existence of rural collective economic organizations, the bankruptcy procedures of rural collective economic organizations will not be applied to the bankruptcy liquidation procedures, but the legal consequences of bankruptcy reorganization can be added to the special law to bring the replacement of personnel in the organization structure of the rural collective economic organizations. In other words, bankruptcy can be used to change the members of the rural collective economic organization, and the members of the rural collective economic organization can be re-elected by holding a general meeting. In this way, the bankruptcy of rural collective economic organizations may directly affect the heads and existing members of rural collective economic organizations. This procedure is designed to encourage the members of the organization to serve the rural collective economic organization with due diligence, loyalty, and prudence and to supervise the reasonable and efficient operation of the rural collective economic organization.

4.2. Learning from the French Bankruptcy Conciliation Pre-procedure System

Enterprise Bankruptcy Law of the People's Republic of China adopts the design idea of "one big door, three small doors" in its procedural design, and bankruptcy settlement, as one of the procedures, has become an important way to solve debt problems, as well as reorganization and liquidation. The value of the bankruptcy conciliation is mainly reflected in bankruptcy prevention, and its procedural advantages are reflected in the principle of majority rule, i.e., unlike general civil conciliation agreements that require the consent of all debtors, a bankruptcy conciliation agreement can be adopted and implemented by a quorum of creditors. Although it is true that the frequency of use of the bankruptcy conciliation system has been low since the implementation of China's Enterprise Bankruptcy Law more than ten years ago, the significance of the bankruptcy conciliation may be more obvious if it is applied to the debt problems of rural collective economic organizations. The bankruptcy conciliation system provides rural collective economic organizations with multiple options for bankruptcy relief, and rural collective economic organizations can choose bankruptcy conciliation process to be free from debt bondage. Bankruptcy conciliation allows rural collective economic organizations to reach agreements on debt repayment with a majority of creditors in bankruptcy proceeding meetings, giving rural collective economic organizations a chance to recover their lives through extensions, installments, reductions, etc. More importantly, the bankruptcy conciliation procedure is less costly and can reduce the investment in manpower, material resources, and time compared with the bankruptcy reorganization procedure, which can reduce the cost of applying bankruptcy procedures to rural collective economic organizations.

Based on the advantages of bankruptcy conciliation for rural collective economic organizations, we believe that we can learn from the French bankruptcy conciliation pre-procedure. Specifically, the French Judicial Reorganization and Judicial Liquidation Law provides that before applying the reorganization to agricultural operators in the form of non-commercial companies, the bankruptcy conciliation procedure must be applied first, and only if the bankruptcy conciliation fails can the reorganization procedure be applied [5]. In this regard, we believe that we can consider providing the conversion rules between bankruptcy conciliation and bankruptcy reorganization in the future bankruptcy relief rules for rural collective
economic organizations, setting bankruptcy conciliation as an optional pre-procedure for bankruptcy reorganization in the special legislation for rural collective economic organizations. When a rural collective economic organization is unable to pay its debts as they fall due and is insolvent or clearly lacks the ability to pay them, the rural collective economic organization is first given the right to choose the bankruptcy conciliation procedure, and if the bankruptcy conciliation fails, it can enter the above-mentioned debt restructuring procedure again, and if the goal of solving the debt dilemma can be achieved directly through the bankruptcy settlement, there is no need to reorganize the debt. It should also be noted that it is up to the rural collective economic organization to decide whether to enter the bankruptcy conciliation process first, it can enter the bankruptcy debt reorganization process directly without choosing the bankruptcy conciliation process.

5. Conclusion

As one of the new types of special legal persons established by the Civil Code, rural collective economic organizations are special in many aspects compared to profit-making legal persons and non-profit legal persons. However, in the context of the reform of rural collective property rights and the market economy, the legislation on rural collective economic organizations should allow them to apply the bankruptcy system, both strategically, conceptually, logically, and practically. At the same time, we should design a bankruptcy system different from the Enterprise Bankruptcy Law at the early stage of the reform, so that it can, not only apply the laws of market operation, thus improving the operational efficiency of the collective economy and providing stronger protection for the rights and interests of creditors and collective members, but also improve the market-oriented operation path of the collective economy under the premise of consolidating the rule of law of the collective ownership system, so as to promote the reform of collective property rights system.

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