



## Credit Legal System Research of Chinese Market Economy – Based on the Financial Crisis Brought by the United States’ Subprime Crisis

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### Abstract

The financial crisis brought by the United States’ subprime crisis is in fact serious problems occurred in financial debt credit basis of the financial market. This paper particularly investigates credit, explores current status of the credit legal system in Chinese market economy, analyzes the United States’ credit legal system and its important inspiration to China, and then proposes some ideas in constructing Chinese credit legal system and suggestions for its perfection in order to contribute to Chinese credit legal system research and legal practice.

**Key words:** Credit; Credit crisis; Protection of rights; Risk prevention

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The Subprime Crisis erupted in the USA has caused the bankruptcy of the world famous investment bank Lehman brothers, Merrill Lynch got taken over, and commercial bank giant RBS and other large European banks’ nationalization. In addition, huge crisis appeared in global major bank markets’ liquidity and a wide range of mass loss also turned up in banking business. This crisis has not only made the banking industry tumbled, but also brought

significant influence upon insurance, capital funds and other financial institutions as subprime loans participants. Then the subprime crisis has turned into a global financial hurricane around the world financial market. The most fundamental reason for this financial crisis is serious problems occurred in the financial debt credit basis of the financial market. Financial debt credit basis is a relative complex system that includes financial debt relationships between financial institutions, for example, interbank lending relationship between banks; financial relationships between companies and financial institutions, e.g. debtor-creditor relationship between normal companies and banks; foreign debt relationships between domestic corporations and overseas banks; and also financial debt relationships occurred when domestic enterprises issue foreign debts or stocks in overseas markets. In a word, financial debts are all based on certain credit basis.

## 1. THE DEFINITION OF CREDIT

### 1.1 Ethical Meaning

Credit is first an ethical concept. Integrity has always been thought as the basic foundation of being a human being, ruling a county, and living in peace from ancient times. As early as in the ancient time, there has been strong ethics in credit aspect. The areas that credit concerns range from individuals to the whole nation and the subject it applied to is also different from each people to the country. In modern times, integrity and honesty has also been reckoned as an existing manner of an ideal personality from inside to outside. It requires people to be honest with each other and keep promises so that to establish mutual trust.

### 1.2 Economic Analysis on Credit

Credit in economics sense is widely applied in financial field and commodity transaction. In financial field, credit is a commodity and monetary lending conduct based on paying interests and principals. In trade field, credit

is social product distribution and exchange which is a special form of value movement. Its particularity is shown at the general imperfect of “interest bearing and pay back theory”; it emphasizes the reconciliation of time and space; it is also a transaction behavior in different time period which is guaranteed by contracts or treaties (Lei & Cai, 2003, p. 23). In economic theory, credit is a special economic ability mainly based on the debt paying ability which is built on trust. This trust is from the ability that the entrusted person can pay back the money no matter its moral characters is bad or good.

### **1.3 Legal Explanation on Credit**

Credit is a unity of subjectivity and objectivity in legal point of view. In the subject view, credit is a kind of interest that people have. It includes not only personality interest but also property interest (Chen & Tang, 2005, p. 5). As for the credit in subjective aspect, the task of law should be the realization of credit guarantee; as for the objective point of view, credit is an objective social evaluation, for which the task of law should be how to effectively guard against the risk. Correspondingly, in the science of law, credit legal regulation is mainly reflected in two aspects: one is the ability of market main body to perform its obligations, which mainly depends on the main body’s property ability in the market and it reflects that the credit foundation is capital credit; On the other hand, it is the condition of market main body’s performance of its obligations, which mainly depends on the credit record. According to different levels of market main body, credit records are generally divided into three grades and reflect the commercial credit conditions.

## **2. INVESTIGATION OF CHINESE CURRENT CREDIT LEGAL SYSTEM**

Chinese has always believed the old saying “people cannot live without credit”. However, in current society, driven by benefits, the main subject of market trades has made ideal stuff pale and weak. The fact has been proved on this point. In the social transformation period, due to the lack of legal system and people’s thinking and understanding deviations, the phenomenon that personal, enterprise and government credit incompleteness has appeared and become one of the prominent problems.

The lack of credit is mainly caused by the incompleteness of legal system: unclear property right leads to the lack of necessary interest-binding mechanism in credit relationship; incomplete competition of market relationship causes the deficiency of functioning basis of credit mechanism; Lack of protection of rights has brought imperfect credit supervising system; intermediary organs, especially accounting firms, do not play their role as “economic polices” but restricting credit mechanism functions.

## **3. ENLIGHTENMENT AND RECONSIDERATION OF THE CREDIT LEGAL SYSTEM IN THE UNITED STATES**

### **3.1 Reconsideration of the United States Default Rating System**

The subprime crisis broke out in the United States in fact is a kind of credit crisis which means the credit system that we always thought are sound has disastrous crisis and the deep level reasons behind this crisis worth of our reconsideration.

First of all, the discreditable default rating system needs to be reconsidered; during the subprime crisis, Moody, Standard & Poor’s and Fitch and other rating organizations have been mostly criticized. Various rating agencies are considered raise the subprime product rating to too high and greatly promoted the development of the subprime mortgage market. These rating agencies’ incomes are mainly from security vendors. This rating system’s leak has aroused widespread concerns. When market rating agencies have problems, credit risk is also following. Second, credit rating agencies lag in response. In this financial crisis, credit rating agencies and the “wall street” were both pushed to the frontiers of critics and their such slowness of response were also widely criticized. Third, some credit rating agencies, even some famous ones gave their ratings as blind as a bat. For the market, they were not responsible for investors. At last, the crisis reflects that there are still some problems in their credit rating system which should be learnt by China.

### **3.2 Enlightenment for China**

Aiming at the above mentioned problems, when set up credit legal system, China should learn from them in order to avoid the same problems. Firstly, increase credit rating organizations’ transparency and disclose rating information timely to avoid large amount discreditable credit rating in the market. Secondly, strengthen supervision on credit rating organizations. Credit rating agencies in the market credit system play an important role so it is necessary to strengthen their supervision in order to make sure they do their jobs. At last, we need to promote the construction of laws and regulations on credit rating agencies. It is because only when laws and regulations are complete, we can realize the stable and long-term development of scientific credit rating agencies and better realize their functions.

## **4. THE CONSTRUCTION OF CHINESE CREDIT LEGAL SYSTEM**

Since credit is a uniform of objective and subjective aspects in legal sense, credit is interest that everyone has in subjective aspect, how to protect credit as a personal interest in other words the right protection system of

micro-body should be the most constitutional part of market economic credit system; in objective sense, credit is an objective evaluation of the society which has great influence on every person, therefore, risk prevention is also very significant.

#### 4.1 Guarantee System for Subject's Rights

Firstly, a significant means of subject's rights guarantee system is rights system. To include credit into the field of rights protection, it then become credit right. Credit right should be one of the most significant personality rights for civil law subject during commercial activities. However, since the content of credit record is connected with right to know and privacy and other issues, we should take notice that we cannot violate civil law subjects' privacy and other civil rights. Secondly, it can be included into property rights. To include credit into incorporeal property to protect by following the protecting model used in protecting intellectual property right. It mainly concerns with two aspects: one is the product credit which can be guaranteed by trademark and patent. The other one is company credit which is usually included in the time-honored brand such as "Quanjudu". To include credit into incorporeal property needs further study on incentive mechanism and whether it is required to give high credit companies exemption, simplifications in procedures, and other preferences. Thirdly, we could choose qualification system to protect subject's rights and deprive certain rights from low-grade market subjects. For example, corporation law stipulates that certain people cannot hold the post of company senior managers and other positions. Market access and entry includes two aspects: 1) professional qualification; 2) credit status. We can see that credit status is an important evaluation target. Last, we could combine rights relief system to realize the protection of subjects' rights. Under market economy system, there are provisions in Anti-Unfair Competition Law of the People's Republic of China in current Chinese legal system stipulating using unfair competition to violate credit and reputation but these provisions only regulate intentional violation. Violation of negligence is stipulated by the Tort Liability Law of the People's Republic of China. The current development direction of rights remedy should be transferred from government supervision and monitoring to competition law. In addition, we should also pay attention to inside division and coordinating in legal system.

#### 4.2 Risk Prevention System

First, improve rating systems including capital rating and credit rating. Some countries let financial organizations

evaluate financial risks in credit rating while we can try to choose "trusted by the masses" enterprises to do this job so that to realize evaluation under the framework of laws and regulations. However, currently, the way of choosing the "trusted by the masses" enterprises cannot be adopted since there is no legal basis for it. Second, develop credit enhancement system whose function is to increase credit and prevent risk. Currently Chinese credit enhancement organizations are scattered in, for example, the industry and commerce departments, banks, and courts without a unified system. Currently, western developed countries' development tendency is to give the power to private organizations. However, there are some difficulties for China to adopt this method for Chinese private organizations' lack of credit. Obviously, it is not mature for China to allow private organizations to act as credit enhancement organizations. Even in the United States with developed legal system, their rating organizations have become the most direct criticized object during the global financial crisis evaluated from the subprime crisis. Therefore, China should seek for resolutions under its current legal framework. Third, establish intermediary system and make use of intermediary companies' functions. Assessment and credit enhancement are both belong to intermediary or social organizations such as non-governmental organizations, trade associations, chamber of commerce, consumers' association and so on. How do they work and how to perfect and improve their functions is the key point of China's market economy credit system construction. Last, improve guarantee system. Risk and credit are inverse ratio. The lower the credit is, the higher the risk is. The responsibility in burdening current civil trade risks has transferred from buyer to the principle of good faith in civil law. In private law field, guarantee system has become the most important risk prevention system in trades. It is very significant to give full play to the legal function of guarantee actively so prevent credit risk of market subjects in the framework of Guaranty Law of the People's Republic of China, Contract Law of the People's Republic of China, and Property Law of the People's Republic of China.

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