U.S.-Asia Law Institute
New York University School of Law

The Social Role of Corporations in Asia-Pacific

Promoting Social Responsibility Through Ratings: China's Corporate Social Credit System

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Published March 31, 2022

Corporate social responsibility (CSR) refers to an initiative or business strategy that aims to do good for society instead of merely generating profits for shareholders. In its original form, CSR refers to voluntary and self-initiating corporate actions that demonstrate a corporation's intention to contribute to society and promote its social image and reputation. In the Western world, the regulatory approach to CSR is facilitating and market-based, and the most commonly seen regulatory measure is disclosure. However, in China, the regulatory approach is state-centric and top-down.[1]

Since 2006, the Communist Party-led government, or party-state, has taken the lead as regulator and controlling shareholders to promote and even mandate CSR-related measures and disclosures. What differentiates China from other nations is that Article 5 of the 2006 Chinese Company Law explicitly requires all companies to be "*socially responsible*."[2] Furthermore, following this amendment, stock exchanges published rules to require listed companies to provide CSR reports. Even though Chinese legal scholars hold different views about how to interpret Article 5 and whether it does impose obligations, the provision demonstrates the firm stand that the Chinese government takes on promoting CSR, making it a distinctly different creature from CSR in the Western business world.

The promotion of CSR fits well with the larger political agenda of the Chinese Communist Party in fostering social harmony and, ultimately, the stability of its rule.[3] In recent years, the China Securities Regulatory Commission (CSRC) and stock exchanges have also gradually included environmental, social, and governance (ESG) disclosure in the regulatory framework. In September 2018, the CSRC added a new chapter on ESG in the Corporate Governance Guideline to encourage listed companies to adopt practices that comply with ESG requirements. In June 2021, the CSRC further singled out the disclosure of ESG

matters in separate sections in the annual report of listed companies and refined the scope of disclosure to include environmental emissions, administrative penalties for breach of environmental regulations, measures for reducing carbon emissions, donations or other actions that reduce poverty, and so on. While the regulatory framework of ESG reporting is still under development in China, state-owned enterprises (SOEs) in general are more responsive to ESG reporting than non-state-owned firms. The 2021 Chinese Listed Company ESG White Paper reported that over 50% of listed SOEs have disclosed ESG reports while only 21% of non-state firms have reported ESG matters. Thus, we also find traces of state-led efforts in the development of ESG in China.

In addition to ESG disclosures, a new trend has emerged in the form of a social credit system to promote corporate social responsibility. This essay aims to introduce this novel regulatory tool used by the Chinese government to promote social responsibility and shape corporate behavior toward stakeholderism.

The Corporate Social Credit System (CSCS)

The release of the Planning Outline for the Construction of a Social Credit System (2014–2020) in 2014 launched a coordinated effort by the Chinese government to build a comprehensive social credit system to grade individuals, businesses, and organizations. The Corporate Social Credit System (CSCS) is a program to amass data on the regulatory compliance, inspections, payments of taxes and court judgments, and civic conduct of every business entity registered in China and to use that data to generate scores and ratings that trigger rewards and punishments. In its 2019 Guiding Opinions, the State Council depicted social credit as the basis for government supervision over market entities and called for the building of a new credit score-based supervision (*xin yong fen ji fen lei jian guan*).[4] This new mechanism provides for firms to be categorized into different levels based on their public credit scores derived from an integrated public credit assessment conducted either at the national or local level, by an industry association or a third-party credit rating agency.[5] Based on the ratings given in accordance with the public credit scores, highly-rated companies will be subject to less supervision, and poorly-rated companies will be warned and subjected to more frequent inspection by local government agencies.[6]

The CSCS is one of the critical infrastructures that the Chinese government is building under the political agendas of digital governance, data-driven governance, and law-based governance. It is a large-scale data collection project carried out by the Chinese government to achieve two main goals. First, it is a regulatory technology (RegTech) project in which the government uses big data to assess companies and to tailor their supervision according to the assessment results. The government reduces the random inspections and supervision imposed on firms that do well in the assessment, while firms that receive poor scores experience an increase in inspection and surveillance measures. In this sense, the CSCS is a project designed to bring about individually calibrated government supervision.

Second, it is a corporate compliance program in which the party-state refines compliance criteria and establishes a joint enforcement scheme across government agencies that increases the cost of non-compliance to companies. It is “Compliance 2.0” for corporations, with all compliance information centralized and collectively enforced by all government agencies. The CSCS is likely to increase the cost of compliance significantly, not only because of joint enforcement by different government agencies but also because each firm must follow the different standards of assessment set by the city, province, and industry to which it belongs. In the foreseeable future, the CSCS will help develop the Chinese market into a self-regulating marketplace in which actors are coerced

and/or incentivized to conform their behavior to norms established by the party-state outside the ordinary channels of law and regulation.

Promoting Social Responsibility through CSCS Ratings

So far, the implementation timeline of social credit assessment has been in the hands of local governments. Implementation currently focuses on building the public credit profile of each business, the data for which can be extracted solely from government records, such as fines, judgments, and business licenses. As of December 15, 2021, seven out of twenty-seven provinces and provincial-level municipalities have published scoring standards for corporate public credit assessment, including the provinces of Shandong, Zhejiang, Shaanxi, Gansu, Jiangsu, Heilongjiang, and Hebei. Even though public credit scores mainly assess a company's compliance with laws and regulations, a close examination of all available scoring standards reveals that all seven provinces also take social responsibility into account in the rating exercise. It appears that the new social credit system has been used by the Chinese government to nudge businesses to incorporate social responsibility practices into their daily operations and compliance work.

Zhejiang Province is the first province to publish its public credit assessment results to the public. There are five major indicators for corporate public credit assessment: basic data, finance, taxation, governance, compliance, and social responsibility. Of these, social responsibility accounts for 185 points out of a maximum public credit score of 1,000. When evaluating a firm's social responsibility performance, Zhejiang Province considers factors such as the company's state-approved volunteer services and donations and the awards it has received from the local government. All other provinces include a similar formula when evaluating social responsibility in social credit ratings. Some provinces, such as Jiangsu, consider whether the business employs veterans or persons with disabilities or hosts public-interest events.[7] Since the CSCS is administered at the local level, each provincial government has the discretion to define what constitutes social responsibility in the public credit assessment and the allocation of social responsibility points within the overall public credit assessment.

Some ESG matters are also included in the social credit assessment. For example, the Zhejiang Province public credit assessment indicators take into account product safety and production quality in the "governance" section, and deduct points if a firm fails government inspection or has production or fire accidents. These are the "social" matters in the ESG reporting framework. Environmental accidents and administrative penalties relating to violation of environmental regulations also can result in point deductions in the "governance" and "compliance" categories of the Zhejiang Province scoring standards.

As the assessment results will affect the intensity of monitoring by the local government and potentially lead to other ramifications as a result of the wider application of CSCS in the future, corporations are likely to be nudged to modify their behaviors to score higher in the public credit assessment exercise. Last year, Alibaba, Tencent, and other Chinese tech giants donated millions of dollars toward flood relief and other charitable causes in response to the party's call to promote "common prosperity." Such donations can indeed boost their social responsibility points in the public credit score system and reduce the likelihood that they will face random inspections and other administrative burdens.[8] In the future, we will likely see more corporations making large donations, participating in volunteer services sanctioned by the party-state, or hosting public-interest events.

By incorporating social responsibility and ESG concepts into the new CSCS, the Chinese government provides additional incentives for

corporations to actively engage with stakeholders and society. Through factoring in social and environmental concerns in the new CSCS, the CCP could impose its own social and political values on businesses. For example, by restricting the type of donations and volunteer services that could be recognized as bonus items, CCP could shape corporate behaviors in the direction favored by the party-state. CSCS thus becomes a policy-channeling tool that CCP utilizes to enhance political control over businesses operating in China.

Notes

[1] Virginia Harper Ho, *Beyond Regulation: A Comparative Look at State-Centric Corporate Social Responsibility and the Law in China*, 46 Vand. J. Transnat'l. L. 375 (2013).

[2] Chinese Company Law (2006), art.5. "When conducting business operations, a company shall comply with the laws and administrative regulations, social morality, and business morality. It shall act in good faith, accept the supervision of the government and general public, and bear social responsibilities."

[3] NDRC, *Circular on Pushing and Applying the Integrated Public Credit Assessment Results of Market Players*, Fa Gai Ban Cai Jin [2019] 885 Hao (Sept. 1, 2019) (hereinafter "2019 NDRC Notice").

[4] 2019 Guiding Opinions, *supra* note 4.

[5] Jiangsu Province Corporate Public Credit Assessment Guideline (Trial), July 1, 2021, https://www.creditchina.gov.cn/zhengcefagui/zhengcefagui/difangzhengcefagui1/202107/t20210720_239936.html (last accessed on Dec. 19, 2021).

[6] *See, e.g.*, Naoki Matsuda & Iori Kawate, "China's Elite Scramble for Path to Xi's "Common Prosperity," Nikkei Asia, Sept. 2, 2021.

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Suggested citation:

Lauren Yu-Hsin Lin, “Promoting Social Responsiblity through Ratings: China’s Corporate Social Credit System” in Symposium on the Social Role of Corporations in Asia-Pacific, https://usali.org/asia-pacific-symposium-essays/promoting-social-responsibility-through-ratings-chinas-corporate-social-credit-system*USALI East-West Studies*, 2, No. 6, March 31, 2022, .

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